

AMENDED IN ASSEMBLY APRIL 30, 2003

AMENDED IN ASSEMBLY APRIL 24, 2003

CALIFORNIA LEGISLATURE—2003–04 REGULAR SESSION

## ASSEMBLY BILL

**No. 651**

**Introduced by Assembly Member Corbett**

February 19, 2003

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An act to add Article 1.8 (commencing with Section 52337) to Chapter 9 of Part 28 of the Education Code, and to amend Sections 6377, 17039, 17053.49, 23036, and 23649 of, and to add and repeal Sections 17053.51 and 23651 of, the Revenue and Taxation Code, relating to taxation, and making an appropriation therefor, *to take effect immediately, tax levy*.

### LEGISLATIVE COUNSEL'S DIGEST

AB 651, as amended, Corbett. Career Technical Education Campaign: sales, use, income, and corporation taxes: manufacturer's investment.

Existing laws provide various programs relating to adult and career education.

This bill would ~~require~~ *declare the Legislature's intent that* the State Department of Education ~~to~~ establish the Career Technical Education Campaign for the purpose of encouraging businesses to make gifts of in-kind donations for career technical education in the state, as provided.

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property and provides various exemptions

from the taxes imposed by that law. That law provides an exemption from those taxes for the gross receipts from the sale of, and the storage, use, or other consumption of, tangible personal property, as defined, purchased for use by a qualified person, as defined, primarily in any state engaged in a new trade or business, as defined, of manufacturing, processing, refining, fabricating, or recycling of property, and introduced into the process, as specified. The Personal Income Tax Law and the Corporation Tax Law authorize various credits against the taxes imposed by those laws, including a credit against taxes imposed by those laws in an amount equal to 6% of the amount paid or incurred by the taxpayer during the taxable year for qualified property, as defined, that is placed in service in this state.

This bill would disallow the sales tax exemption unless the qualified person or taxpayer, as applicable, is certified as a participant in the Career Technical Education Campaign, as provided. This bill would reduce the income and corporation tax credit percentage from 6% to 1% over a 5-year period, as provided, and would eliminate those credits as of January 1, 2011. This bill would also allow, until January 1, 2012, similar new income and corporation tax credits, restricted to participants in the campaign, in increasing amounts from 2% to 7% over a 5-year period, as specified.

This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of  $\frac{2}{3}$  of the membership of each house of the Legislature.

This bill would appropriate an unspecified amount from the General Fund to the Franchise Tax Board ~~and the State Department of Education~~, as provided.

*This bill would take effect immediately as a tax levy.*

Vote:  $\frac{2}{3}$ . Appropriation: yes. Fiscal committee: yes. State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. Article 1.8 (commencing with Section 52337)  
 2 is added to Chapter 9 of Part 28 of the Education Code, to read:  
 3

Article 1.8. Career Technical Education Campaign

~~52337. The~~ *It is the intent of the Legislature that the State Department of Education shall establish the Career Technical Education Campaign for the purpose of encouraging businesses to make gifts of in-kind donations for career technical education in the state.* ~~The~~ *It is further the intent of the Legislature that the State Department of Education shall adopt rules and regulations in 2004, to do the following:*

(a) Establish procedures, processes, and criteria according to which a business may, for purposes of Sections 6377, 17053.51, and 23651 of the Revenue and Taxation Code, be considered a qualified participant in ~~the campaign authorized~~ *a campaign as described* by this article.

(b) Establish the valuation mechanism that will determine if a taxpayer is a “qualified participant” for purposes of Sections 17053.51 and 23651 of the Revenue and Taxation Code.

(c) Certify qualified participants in ~~the campaign authorized~~ *a campaign as described* by this article and provide a list of certified qualified participants to the Franchise Tax Board and the State Board of Equalization, as appropriate, in the manner most efficient for the department and those agencies.

SEC. 2. Section 6377 of the Revenue and Taxation Code is amended to read:

6377. (a) There are exempted from the taxes imposed by this part the gross receipts from the sale of, and the storage, use, or other consumption in this state of, any of the following:

(1) Tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered property to its completed form, including packaging, if required.

(2) Tangible personal property purchased for use by a qualified person to be used primarily in research and development.

(3) Tangible personal property purchased for use by a qualified person to be used primarily to maintain, repair, measure, or test any property described in paragraph (1) or (2).

(4) Tangible personal property purchased for use by a contractor purchasing that property either as an agent of a qualified person or for the contractor's own account and subsequent resale to a qualified person for use in the performance of a construction contract for the qualified person who will use the tangible personal property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with the manufacturing process.

This exemption shall not apply to any tangible personal property that is used primarily in administration, general management, or marketing.

(b) For purposes of this section:

(1) "Fabricating" means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(3) "Primarily" means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a).

(4) "Process" means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer's manufacturing, processing, refining, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer's manufacturing, processing, refining, fabricating, or recycling activity is

1 conducted, shall not be considered to have been introduced into the  
2 manufacturing, processing, refining, fabricating, or recycling  
3 process.

4 (5) “Processing” means the physical application of the  
5 materials and labor necessary to modify or change the  
6 characteristics of property.

7 (6) “Qualified person” means any person that is all of the  
8 following:

9 (A) A new trade or business. In determining whether a trade or  
10 business activity qualifies as a new trade or business, the following  
11 rules shall apply:

12 (i) In any case where a person purchases or otherwise acquires  
13 all or any portion of the assets of an existing trade or business  
14 (irrespective of the form of entity) that is doing business in this  
15 state (within the meaning of Section 23101), the trade or business  
16 thereafter conducted by that person (or any related person) shall  
17 not be treated as a new business if the aggregate fair market value  
18 of the acquired assets (including, real, personal, tangible, and  
19 intangible property) used by that person (or any related person) in  
20 the conduct of his or her trade or business exceed 20 percent of the  
21 aggregate fair market value of the total assets of the trade or  
22 business being conducted by the person (or any related person).  
23 For purposes of this subparagraph only, the following rules shall  
24 apply:

25 (I) The determination of the relative fair market values of the  
26 acquired assets and the total assets shall be made as of the last day  
27 of the month following the quarterly period in which the person (or  
28 any related person) first uses any of the acquired trade or business  
29 assets in his or her business activity.

30 (II) Any acquired assets that constituted property described in  
31 Section 1221(1) of the Internal Revenue Code in the hands of the  
32 transferor shall not be treated as assets acquired from an existing  
33 trade or business, unless those assets also constitute property  
34 described in Section 1221(1) of the Internal Revenue Code in the  
35 hands of the acquiring person (or related person).

36 (ii) In any case where a person (or any related person) is  
37 engaged in one or more trade or business activities in this state, or  
38 has been engaged in one or more trade or business activities in this  
39 state within the preceding 36 months (“prior trade or business  
40 activity”), and thereafter commences an additional trade or

1 business activity in this state, the additional trade or business  
2 activity shall only be treated as a new business if the additional  
3 trade or business activity is classified under a different division of  
4 the Standard Industrial Classification Manual published by the  
5 United States Office of Management and Budget, 1987 edition,  
6 than are any of the person's (or any related person's) current or  
7 prior trade or business activities in this state.

8 (iii) In any case where a person, including all related persons,  
9 is engaged in trade or business activities wholly outside of this  
10 state and that person first commences doing business in this state  
11 (within the meaning of Section 23101) after December 31, 1993  
12 (other than by purchase or other acquisition described in clause  
13 (i)), the trade or business activity shall be treated as a new business.

14 (iv) In any case where the legal form under which a trade or  
15 business activity is being conducted is changed, the change in form  
16 shall be disregarded and the determination of whether the trade or  
17 business activity is a new business shall be made by treating the  
18 person as having purchased or otherwise acquired all or any  
19 portion of the assets of an existing trade or business under the rules  
20 of clause (i).

21 (v) "Related person" means any person that is related to that  
22 person under either Section 267 or 318 of the Internal Revenue  
23 Code.

24 (vi) "Acquire" includes any gift, inheritance, transfer incident  
25 to divorce, or any other transfer, whether or not for consideration.

26 (B) Engaged in those lines of business described in Codes 2011  
27 to 3999, inclusive, of the Standard Industrial Classification  
28 Manual published by the United States Office of Management and  
29 Budget, 1987 edition.

30 (C) Certified, in the form and manner prescribed by the board,  
31 as a participant in the Career Technical Education Campaign  
32 pursuant to Section 52337 of the Education Code for the year for  
33 which an exemption is claimed under this section.

34 (7) Notwithstanding paragraph (6), "qualified person" shall  
35 not include any person who has conducted business activities in a  
36 new trade or business for three or more years.

37 (8) "Refining" means the process of converting a natural  
38 resource to an intermediate or finished product.



(9) “Research and development” means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) “Tangible personal property” does not include any of the following:

(A) Consumables with a normal useful life of less than one year, except as provided in subparagraph (E) of paragraph (10).

(B) Furniture, inventory, equipment used in the extraction process, or equipment used to store finished products that have completed the manufacturing process.

(C) Any property for which a credit is claimed under either Section 17053.49 or 23649.

(11) “Tangible personal property” includes, but is not limited to, all of the following:

(A) Machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures.

(B) All equipment or devices used or required to operate, control, regulate, or maintain the machinery, including, without limitation, computers, data processing equipment, and computer software, together with all repair and replacement parts with a useful life of one or more years therefor, whether purchased separately or in conjunction with a complete machine and regardless of whether the machine or component parts are assembled by the taxpayer or another party.

(C) Property used in pollution control that meets or exceeds standards established by this state or any local or regional governmental agency within this state.

(D) Special purpose buildings and foundations used as an integral part of the manufacturing, processing, refining, or fabricating process, or that constitute a research or storage facility used during the manufacturing process. Buildings used solely for warehousing purposes after completion of the manufacturing process are not included.

(E) Fuels used or consumed in the manufacturing process.

(F) Property used in recycling.

(c) No exemption shall be allowed under this section unless the purchaser furnishes the retailer with an exemption certificate, completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes



1 the board with a copy of the exemption certificate. The exemption  
2 certificate shall contain the sales price of the machinery or  
3 equipment that is exempt pursuant to subdivision (a).

4 (d) Notwithstanding any provision of the Bradley-Burns  
5 Uniform Local Sales and Use Tax Law (Part 1.5 (commencing  
6 with Section 7200)) or the Transactions and Use Tax Law (Part 1.6  
7 (commencing with Section 7251)), the exemption established by  
8 this section shall not apply with respect to any tax levied by a  
9 county, city, or district pursuant to, or in accordance with, either  
10 of those laws.

11 (e) (1) Notwithstanding subdivision (a), the exemption  
12 provided by this section shall not apply to any sale or use of  
13 property which, within one year from the date of purchase, is either  
14 removed from California or converted from an exempt use under  
15 subdivision (a) to some other use not qualifying for the exemption.

16 (2) Notwithstanding subdivision (a), on or after January 1,  
17 1995, the exemption established by this section shall not apply  
18 with respect to any tax levied pursuant to Sections 6051.2 and  
19 6201.2, or pursuant to Section 35 of Article XIII of the California  
20 Constitution.

21 (f) If a purchaser certifies in writing to the seller that the  
22 property purchased without payment of the tax will be used in a  
23 manner entitling the seller to regard the gross receipts from the sale  
24 as exempt from the sales tax, and within one year from the date of  
25 purchase, the purchaser (1) removes that property outside  
26 California, (2) converts that property for use in a manner not  
27 qualifying for the exemption, or (3) uses that property in a manner  
28 not qualifying for the exemption, the purchaser shall be liable for  
29 payment of sales tax, with applicable interest, as if the purchaser  
30 were a retailer making a retail sale of the property at the time the  
31 property is so removed, converted, or used, and the sales price of  
32 the property to the purchaser shall be deemed the gross receipts  
33 from that retail sale.

34 (g) (1) This section shall remain in effect until the date  
35 specified in paragraph (2), on which date this section shall cease  
36 to be operative, and as of that date is repealed.

37 (2) (A) This section shall cease to be operative on January 1,  
38 2001, or on January 1 of the earliest year thereafter, if the total  
39 employment in this state, as determined by the Employment  
40 Development Department on the preceding January 1, does not



1 exceed by 100,000 jobs the total employment in this state on  
2 January 1, 1994. The department shall report annually to the  
3 Legislature with respect to the determination required by the  
4 preceding sentence.

5 (B) For purposes of this paragraph, “total employment” means  
6 the total employment in the manufacturing sector, excluding  
7 employment in the aerospace sector.

8 (h) This section applies to leases of tangible personal property  
9 classified as “continuing sales” and “continuing purchases” in  
10 accordance with Sections 6006.1 and 6010.1. The exemption  
11 established by this section shall apply to the rentals payable  
12 pursuant to such a lease, provided the lessee is a qualified person  
13 and the property is used in an activity described in subdivision (a).  
14 Rentals which meet the foregoing requirements are eligible for the  
15 exemption for a period of six years from the date of  
16 commencement of the lease. At the close of the six-year period  
17 from the date of commencement of the lease, lease receipts are  
18 subject to tax without exemption.

19 SEC. 3. Section 17039 of the Revenue and Taxation Code is  
20 amended to read:

21 17039. (a) Notwithstanding any provision in this part to the  
22 contrary, for the purposes of computing tax credits, the term “net  
23 tax” means the tax imposed under either Section 17041 or 17048  
24 plus the tax imposed under Section 17504 (relating to lump-sum  
25 distributions) less the credits allowed by Section 17054 (relating  
26 to personal exemption credits) and any amount imposed under  
27 paragraph (1) of subdivision (d) and paragraph (1) of subdivision  
28 (e) of Section 17560. Notwithstanding the preceding sentence, the  
29 “net tax” shall not be less than the tax imposed under Section  
30 17504 (relating to the separate tax on lump-sum distributions), if  
31 any. Credits shall be allowed against “net tax” in the following  
32 order:

33 (1) Credits that do not contain carryover or refundable  
34 provisions, except those described in paragraphs (4) and (5).

35 (2) Credits that contain carryover provisions but do not contain  
36 refundable provisions, except for those that are allowed to reduce  
37 “net tax” below the tentative minimum tax, as defined by Section  
38 17062.

39 (3) Credits that contain both carryover and refundable  
40 provisions.

1 (4) The minimum tax credit allowed by Section 17063 (relating  
2 to the alternative minimum tax).

3 (5) Credits that are allowed to reduce “net tax” below the  
4 tentative minimum tax, as defined by Section 17062.

5 (6) Credits for taxes paid to other states allowed by Chapter 12  
6 (commencing with Section 18001).

7 (7) Credits that contain refundable provisions but do not  
8 contain carryover provisions.

9 The order within each paragraph shall be determined by the  
10 Franchise Tax Board.

11 (b) Notwithstanding the provisions of Sections 17061 (relating  
12 to refunds pursuant to the Unemployment Insurance Code) and  
13 19002 (relating to tax withholding), the credits provided in those  
14 sections shall be allowed in the order provided in paragraph (6) of  
15 subdivision (a).

16 (c) (1) Notwithstanding any other provision of this part, no tax  
17 credit shall reduce the tax imposed under Section 17041 or 17048  
18 plus the tax imposed under Section 17504 (relating to the separate  
19 tax on lump-sum distributions) below the tentative minimum tax,  
20 as defined by Section 17062, except the following credits:

21 (A) The credit allowed by Section 17052.2 (relating to teacher  
22 retention tax credit).

23 (B) The credit allowed by former Section 17052.4 (relating to  
24 solar energy).

25 (C) The credit allowed by former Section 17052.5 (relating to  
26 solar energy, repealed on January 1, 1987).

27 (D) The credit allowed by former Section 17052.5 (relating to  
28 solar energy, repealed on December 1, 1994).

29 (E) The credit allowed by Section 17052.12 (relating to  
30 research expenses).

31 (F) The credit allowed by former Section 17052.13 (relating to  
32 sales and use tax credit).

33 (G) The credit allowed by former Section 17052.15 (relating to  
34 Los Angeles Revitalization Zone sales tax credit).

35 (H) The credit allowed by Section 17052.25 (relating to the  
36 adoption costs credit).

37 (I) The credit allowed by Section 17053.5 (relating to the  
38 renter’s credit).

39 (J) The credit allowed by former Section 17053.8 (relating to  
40 enterprise zone hiring credit).



1 (K) The credit allowed by former Section 17053.10 (relating to  
2 Los Angeles Revitalization Zone hiring credit).

3 (L) The credit allowed by former Section 17053.11 (relating to  
4 program area hiring credit).

5 (M) For each taxable year beginning on or after January 1,  
6 1994, the credit allowed by former Section 17053.17 (relating to  
7 Los Angeles Revitalization Zone hiring credit).

8 (N) The credit allowed by Section 17053.33 (relating to  
9 targeted tax area sales or use tax credit).

10 (O) The credit allowed by Section 17053.34 (relating to  
11 targeted tax area hiring credit).

12 (P) The credit allowed by Section 17053.49 (relating to  
13 qualified property).

14 (Q) The credit allowed by Section 17053.51 (relating to career  
15 technical education campaign).

16 (R) The credit allowed by Section 17053.70 (relating to  
17 enterprise zone sales or use tax credit).

18 (S) The credit allowed by Section 17053.74 (relating to  
19 enterprise zone hiring credit).

20 (T) The credit allowed by Section 17054 (relating to credits for  
21 personal exemption).

22 (U) The credit allowed by Section 17054.5 (relating to the  
23 credits for a qualified joint custody head of household and a  
24 qualified taxpayer with a dependent parent).

25 (V) The credit allowed by Section 17054.7 (relating to the  
26 credit for a senior head of household).

27 (W) The credit allowed by former Section 17057 (relating to  
28 clinical testing expenses).

29 (X) The credit allowed by Section 17058 (relating to  
30 low-income housing).

31 (Y) The credit allowed by Section 17061 (relating to refunds  
32 pursuant to the Unemployment Insurance Code).

33 (Z) Credits for taxes paid to other states allowed by Chapter 12  
34 (commencing with Section 18001).

35 (AA) The credit allowed by Section 19002 (relating to tax  
36 withholding).

37 (2) Any credit that is partially or totally denied under paragraph  
38 (1) shall be allowed to be carried over and applied to the net tax in  
39 succeeding taxable years, if the provisions relating to that credit

1 include a provision to allow a carryover when that credit exceeds  
2 the net tax.

3 (d) Unless otherwise provided, any remaining carryover of a  
4 credit allowed by a section that has been repealed or made  
5 inoperative shall continue to be allowed to be carried over under  
6 the provisions of that section as it read immediately prior to being  
7 repealed or becoming inoperative.

8 (e) (1) Unless otherwise provided, if two or more taxpayers  
9 (other than husband and wife) share in costs that would be eligible  
10 for a tax credit allowed under this part, each taxpayer shall be  
11 eligible to receive the tax credit in proportion to his or her  
12 respective share of the costs paid or incurred.

13 (2) In the case of a partnership, the credit shall be allocated  
14 among the partners pursuant to a written partnership agreement in  
15 accordance with Section 704 of the Internal Revenue Code,  
16 relating to partner's distributive share.

17 (3) In the case of a husband and wife who file separate returns,  
18 the credit may be taken by either or equally divided between them.

19 (f) Unless otherwise provided, in the case of a partnership, any  
20 credit allowed by this part shall be computed at the partnership  
21 level, and any limitation on the expenses qualifying for the credit  
22 or limitation upon the amount of the credit shall be applied to the  
23 partnership and to each partner.

24 (g) (1) With respect to any taxpayer that directly or indirectly  
25 owns an interest in a business entity that is disregarded for tax  
26 purposes pursuant to Section 23038 and any regulations  
27 thereunder, the amount of any credit or credit carryforward  
28 allowable for any taxable year attributable to the disregarded  
29 business entity shall be limited in accordance with paragraphs (2)  
30 and (3).

31 (2) The amount of any credit otherwise allowed under this part,  
32 including any credit carryover from prior years, that may be  
33 applied to reduce the taxpayer's "net tax," as defined in  
34 subdivision (a), for the taxable year shall be limited to an amount  
35 equal to the excess of the taxpayer's regular tax (as defined in  
36 Section 17062), determined by including income attributable to  
37 the disregarded business entity that generated the credit or credit  
38 carryover, over the taxpayer's regular tax (as defined in Section  
39 17062), determined by excluding the income attributable to that  
40 disregarded business entity. No credit shall be allowed if the

1 taxpayer's regular tax (as defined in Section 17062), determined  
2 by including the income attributable to the disregarded business  
3 entity, is less than the taxpayer's regular tax (as defined in Section  
4 17062), determined by excluding the income attributable to the  
5 disregarded business entity.

6 (3) If the amount of a credit allowed pursuant to the section  
7 establishing the credit exceeds the amount allowable under this  
8 subdivision in any taxable year, the excess amount may be carried  
9 over to subsequent taxable years pursuant to subdivisions (c) and  
10 (d).

11 (h) (1) Unless otherwise specifically provided, in the case of  
12 a taxpayer that is a partner or shareholder of an eligible  
13 pass-through entity described in paragraph (2), any credit passed  
14 through to the taxpayer in the taxpayer's first taxable year  
15 beginning on or after the date the credit is no longer operative may  
16 be claimed by the taxpayer in that taxable year, notwithstanding  
17 the repeal of the statute authorizing the credit prior to the close of  
18 that taxable year.

19 (2) For purposes of this subdivision, "eligible pass-through  
20 entity" means any partnership or S corporation that files its return  
21 on a fiscal year basis pursuant to Section 18566, and that is entitled  
22 to a credit pursuant to this part for the taxable year that begins  
23 during the last year the credit is operative.

24 (3) This subdivision shall apply to credits that become  
25 inoperative on or after the operative date of the act adding this  
26 subdivision.

27 SEC. 4. Section 17053.49 of the Revenue and Taxation Code  
28 is amended to read:

29 17053.49. (a) (1) A qualified taxpayer shall be allowed a  
30 credit against the "net tax," as defined in Section 17039, equal to  
31 the applicable percentage of the qualified cost of qualified  
32 property that is placed in service in this state. For purposes of this  
33 subdivision, the applicable percentage is:

34 (A) Six percent for property placed in service before January  
35 1, 2005.

36 (B) Five percent for property placed in service on or after  
37 January 1, 2005, and before January 1, 2006.

38 (C) Four percent for property placed in service on or after  
39 January 1, 2006, and before January 1, 2007.

1 (D) Three percent for property placed in service on or after  
2 January 1, 2007, and before January 1, 2008.

3 (E) Two percent for property placed in service on or after  
4 January 1, 2008, and before January 1, 2009.

5 (F) One percent for property placed in service on or after  
6 January 1, 2009, and before January 1, 2010.

7 (2) In the case of any qualified costs paid or incurred on or after  
8 January 1, 1994, and prior to the first taxable year of the qualified  
9 taxpayer beginning on or after January 1, 1995, the credit provided  
10 under paragraph (1) shall be claimed by the qualified taxpayer on  
11 the qualified taxpayer's return for the first taxable year beginning  
12 on or after January 1, 1995. No credit shall be claimed under this  
13 section on a return filed for any taxable year commencing prior to  
14 the qualified taxpayer's first taxable year beginning on or after  
15 January 1, 1995.

16 (b) (1) For purposes of this section, "qualified cost" means  
17 any cost that satisfies each of the following conditions:

18 (A) Except as otherwise provided in this subparagraph, is a cost  
19 paid or incurred by the qualified taxpayer for the construction,  
20 reconstruction, or acquisition of qualified property on or after  
21 January 1, 1994, and prior to the date this section ceases to be  
22 operative under paragraph (2) of subdivision (i). In the case of any  
23 qualified property constructed, reconstructed, or acquired by the  
24 qualified taxpayer (or any person related to the qualified taxpayer  
25 within the meaning of Section 267 or 707 of the Internal Revenue  
26 Code) pursuant to a binding contract in existence on or prior to  
27 January 1, 1994, costs paid pursuant to that contract shall be  
28 subject to allocation as follows: contract costs shall be allocated to  
29 qualified property based on a ratio of costs actually paid prior to  
30 January 1, 1994, and total contract costs actually paid. "Cost paid"  
31 shall include, without limitation, contractual deposits and option  
32 payments. To the extent of costs allocated, whether or not currently  
33 deductible or depreciable for tax purposes, to a period prior to  
34 January 1, 1994, the cost shall be deemed allocated to property  
35 acquired before January 1, 1994, and is thus not a "qualified cost."

36 (B) Except as provided in paragraph (3) of subdivision (d) and  
37 subparagraph (B) of paragraph (4) of subdivision (d), is an amount  
38 upon which the qualified taxpayer has paid, directly or indirectly,  
39 as a separately stated contract amount or as determined from the

1 records of the qualified taxpayer, sales or use tax under Part 1  
2 (commencing with Section 6001).

3 (C) Is an amount properly chargeable to the capital account of  
4 the qualified taxpayer.

5 (2) (A) For purposes of this subdivision, any contract entered  
6 into on or after January 1, 1994, that is a successor or replacement  
7 contract to a contract that was binding prior to January 1, 1994,  
8 shall be treated as a binding contract in existence prior to January  
9 1, 1994.

10 (B) If a successor or replacement contract is entered into on or  
11 after January 1, 1994, and the subject of the successor or  
12 replacement contract relates both to amounts for the construction,  
13 reconstruction, or acquisition of qualified property described in  
14 the original binding contract and to costs for the construction,  
15 reconstruction, or acquisition of qualified property not described  
16 in the original binding contract, then the portion of those amounts  
17 described in the successor or replacement contract that were not  
18 described in the original binding contract shall not be treated as  
19 costs paid or incurred pursuant to a binding contract in existence  
20 on or prior to January 1, 1994, under subparagraph (A) of  
21 paragraph (1).

22 (3) (A) For purposes of this section, an option contract in  
23 existence prior to January 1, 1994, under which a qualified  
24 taxpayer (or any other person related to the qualified taxpayer  
25 within the meaning of Section 267 or 707 of the Internal Revenue  
26 Code) had an option to acquire qualified property, shall be treated  
27 as a binding contract under the rules in paragraph (2). For purposes  
28 of this subparagraph, an option contract shall not include an option  
29 under which the optionholder will forfeit an amount less than 10  
30 percent of the fixed option price in the event the option is not  
31 exercised.

32 (B) For purposes of this section, a contract shall be treated as  
33 binding even if the contract is subject to a condition.

34 (4) For purposes of this subdivision, in the case of any qualified  
35 taxpayer engaged in those lines of business described in Codes  
36 7371 to 7373, inclusive, of the Standard Industrial Classification  
37 (SIC) Manual published by the United States Office of  
38 Management and Budget, 1987 edition, “the first taxable year  
39 beginning on or after January 1, 1998,” shall be substituted for  
40 “January 1, 1994,” in each place in which it appears.



(c) (1) For purposes of this section, “qualified taxpayer” means any taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23649 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or S corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) For purposes of this section, “qualified property” means property that is described as any of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(B) In research and development.

(C) To maintain, repair, measure, or test any property described in this paragraph.

1 (D) For pollution control that meets or exceeds standards  
2 established by the state or by any local or regional governmental  
3 agency within the state.

4 (E) For recycling.

5 (2) Computers and computer peripheral equipment, as defined  
6 in Section 168(i)(2)(B) of the Internal Revenue Code, that is  
7 tangible personal property as defined in Section 1245(a) of the  
8 Internal Revenue Code for use by a qualified taxpayer in those  
9 lines of business described in SIC Codes 7371 to 7373, inclusive,  
10 of the SIC Manual, 1987 edition, that is primarily used to develop  
11 or manufacture prepackaged software or custom software  
12 prepared to the special order of the purchaser who uses the  
13 program to produce and sell or license copies of the program as  
14 prepackaged software.

15 (3) The value of any capitalized labor costs that are directly  
16 allocable to the construction or modification of property described  
17 in paragraph (1) or (2).

18 (4) In the case of any qualified taxpayer engaged in  
19 manufacturing activities described in SIC Code 357 or 367, those  
20 activities related to biotechnology described in SIC Code 8731,  
21 those activities related to biopharmaceutical establishments only  
22 that are described in SIC Codes 2833 to 2836, inclusive, those  
23 activities related to space vehicles and parts described in SIC  
24 Codes 3761 to 3769, inclusive, those activities related to space  
25 satellites and communications satellites and equipment described  
26 in SIC Codes 3663 and 3812 (but only with respect to “qualified  
27 property” that is placed in service on or after January 1, 1996), or  
28 those activities related to semiconductor equipment  
29 manufacturing described in SIC Code 3559 (but only with respect  
30 to “qualified property” that is placed in service on or after January  
31 1, 1997), “qualified property” also includes the following:

32 (A) Special purpose buildings and foundations that are  
33 constructed or modified for use by the qualified taxpayer primarily  
34 in a manufacturing, processing, refining, or fabricating process, or  
35 as a research or storage facility primarily used in connection with  
36 a manufacturing process.

37 (B) The value of any capitalized labor costs that are directly  
38 allocable to the construction or modification of special purpose  
39 buildings and foundations that are used primarily in the  
40 manufacturing, processing, refining, or fabricating process, or as

1 a research or storage facility primarily used in connection with a  
2 manufacturing process.

3 (C) (i) For purposes of this paragraph, “special purpose  
4 building and foundation” means only a building and the  
5 foundation immediately underlying the building that is  
6 specifically designed and constructed or reconstructed for the  
7 installation, operation, and use of specific machinery and  
8 equipment with a special purpose, which machinery and  
9 equipment, after installation, will become affixed to or a fixture of  
10 the real property, and the construction or reconstruction of which  
11 is specifically designed and used exclusively for the specified  
12 purposes as set forth in subparagraph (A) (“qualified purpose”).

13 (ii) A building is specifically designed and constructed or  
14 modified for a qualified purpose if it is not economical to design  
15 and construct the building for the intended purpose and then use  
16 the structure for a different purpose.

17 (iii) For purposes of clause (i) and clause (vi), a building is used  
18 exclusively for a qualified purpose only if its use does not include  
19 a use for which it was not specifically designed and constructed or  
20 modified. Incidental use of a building for nonqualified purposes  
21 does not preclude the building from being a special purpose  
22 building. “Incidental use” means a use which is both related and  
23 subordinate to the qualified purpose. It will be conclusively  
24 presumed that a use is not subordinate if more than one-third of the  
25 total usable volume of the building is devoted to a use which is not  
26 a qualified purpose.

27 (iv) In the event an entire building does not qualify as a special  
28 purpose building, a taxpayer may establish that a portion of a  
29 building, and the foundation immediately underlying the portion,  
30 qualifies for treatment as a special purpose building and  
31 foundation if the portion satisfies all of the definitional provisions  
32 in this subparagraph.

33 (v) To the extent that a building is not a special purpose  
34 building as defined above, but a portion of the building qualifies  
35 for treatment as a special purpose building, then all equipment  
36 which exclusively supports the qualified purpose occurring within  
37 that portion and which would qualify as Internal Revenue Code  
38 Section 1245 property if it were not a fixture or affixed to the  
39 building shall be treated as a cost of the portion of the building  
40 which qualifies for treatment as a special purpose building.



(vi) Buildings and foundations which do not meet the definition of a special purpose building and foundation set forth above include, but are not limited to: buildings designed and constructed or reconstructed principally to function as a general purpose manufacturing, industrial, or commercial building; research facilities that are used primarily prior to or after, or prior to and after, the manufacturing process; or storage facilities that are used primarily prior to or after, or prior to and after, completion of the manufacturing process. A research facility shall not be considered to be used primarily prior to or after, or prior to and after, the manufacturing process if its purpose and use relate exclusively to the development and regulatory approval of the manufacturing process for specific biopharmaceutical products. A research facility which is used primarily in connection with the discovery of an organism from which a biopharmaceutical product or process is developed does not meet the requirements of the preceding sentence.

(5) Subject to the provisions in subparagraph (B) of paragraph (1) of subdivision (b), qualified property also includes computer software that is primarily used for those purposes set forth in paragraph (1) or (2) of this subdivision.

(6) Qualified property does not include any of the following:

(A) Furniture.

(B) Facilities used for warehousing purposes after completion of the manufacturing process.

(C) Inventory.

(D) Equipment used in the extraction process.

(E) Equipment used to store finished products that have completed the manufacturing process.

(F) Any tangible personal property that is used in administration, general management, or marketing.

(G) Any vehicle for which a credit is claimed pursuant to Section 17052.11 or 23603.

(e) For purposes of this section:

(1) "Biopharmaceutical activities" means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to

1 pharmaceutical activities which make use of chemical compounds  
2 to produce commercial products.

3 (2) “Fabricating” means to make, build, create, produce, or  
4 assemble components or property to work in a new or different  
5 manner.

6 (3) “Manufacturing” means the activity of converting or  
7 conditioning property by changing the form, composition, quality,  
8 or character of the property for ultimate sale at retail or use in the  
9 manufacturing of a product to be ultimately sold at retail.  
10 Manufacturing includes any improvements to tangible personal  
11 property that result in a greater service life or greater functionality  
12 than that of the original property.

13 (4) “Other biotechnology activities” means activities  
14 consisting of the application of recombinant DNA technology to  
15 produce commercial products, as well as activities regarding  
16 pharmaceutical delivery systems designed to provide a measure of  
17 control over the rate, duration, and site of pharmaceutical delivery.

18 (5) “Primarily” means tangible personal property used 50  
19 percent or more of the time in an activity described in subdivision  
20 (d).

21 (6) “Process” means the period beginning at the point at which  
22 any raw materials are received by the qualified taxpayer and  
23 introduced into the manufacturing, processing, refining,  
24 fabricating, or recycling activity of the qualified taxpayer and  
25 ending at the point at which the manufacturing, processing,  
26 refining, fabricating, or recycling activity of the qualified taxpayer  
27 has altered tangible personal property to its completed form,  
28 including packaging, if required. Raw materials shall be  
29 considered to have been introduced into the process when the raw  
30 materials are stored on the same premises where the qualified  
31 taxpayer’s manufacturing, processing, refining, or recycling  
32 activity is conducted. Raw materials that are stored on premises  
33 other than where the qualified taxpayer’s manufacturing,  
34 processing, refining, fabricating, or recycling activity is  
35 conducted, shall not be considered to have been introduced into the  
36 manufacturing, processing, refining, fabricating, or recycling  
37 process.

38 (7) “Processing” means the physical application of the  
39 materials and labor necessary to modify or change the  
40 characteristics of property.

1 (8) “Refining” means the process of converting a natural  
2 resource to an intermediate or finished product.

3 (9) “Research and development” means those activities that  
4 are described in Section 174 of the Internal Revenue Code or in any  
5 regulations thereunder.

6 (10) “Small business” means a qualified taxpayer that meets  
7 any of the following requirements during the taxable year for  
8 which the credit is allowed:

9 (A) Has gross receipts of less than fifty million dollars  
10 (\$50,000,000).

11 (B) Has net assets of less than fifty million dollars  
12 (\$50,000,000).

13 (C) Has a total credit of less than one million dollars  
14 (\$1,000,000).

15 (D) For taxable years beginning on or after January 1, 1997, is  
16 engaged in biopharmaceutical activities or other biotechnology  
17 activities that are described in Codes 2833 to 2836, inclusive, of  
18 the Standard Industrial Classification (SIC) Manual published by  
19 the United States Office of Management and Budget, 1987 edition,  
20 and has not received regulatory approval for any product from the  
21 United States Food and Drug Administration.

22 (f) The credit allowed under subdivision (a) shall apply to  
23 qualified property that is acquired by or subject to lease by a  
24 qualified taxpayer, subject to the following special rules:

25 (1) A lessor of qualified property, irrespective of whether the  
26 lessor is a qualified taxpayer, shall not be allowed the credit  
27 provided under subdivision (a) with respect to any qualified  
28 property leased to another qualified taxpayer.

29 (2) For purposes of paragraphs (2) and (3) of subdivision (b),  
30 “binding contract” shall include any lease agreement with respect  
31 to the qualified property.

32 (3) (A) For purposes of determining the qualified cost paid or  
33 incurred by a lessee in any leasing transaction that is not treated as  
34 a sale under Part 1 (commencing with Section 6001), the following  
35 rules shall apply:

36 (i) Except as provided by subparagraph (C) of this paragraph,  
37 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)  
38 shall not apply.

39 (ii) Except as provided in subparagraph (B) and clause (iii), the  
40 “qualified cost” upon which the lessee shall compute the credit

1 provided under this section shall be equal to the original cost to the  
2 lessor (within the meaning of Section 18031) of the qualified  
3 property that is the subject of the lease.

4 (iii) Except as provided in clause (iv), the requirement of  
5 subparagraph (B) of paragraph (1) of subdivision (b) shall be  
6 treated as satisfied only if the lessor has made a timely election  
7 under either Section 6094.1 or subdivision (d) of Section 6244 and  
8 has paid sales tax reimbursement or use tax measured by the  
9 purchase price of the qualified property (within the meaning of  
10 paragraph (5) of subdivision (g) of Section 6006). For purposes of  
11 this subdivision and clause (iv), the amount of original cost to the  
12 lessor which may be taken into account under clause (ii) shall not  
13 exceed the purchase price upon which sales tax reimbursement or  
14 use tax has been paid under the preceding sentence or under clause  
15 (iv).

16 (iv) With respect to leases entered into between January 1,  
17 1994, and the effective date of this clause, the lessor may elect to  
18 pay use tax measured by the purchase price of the property by  
19 reporting and paying the tax with the return of the lessor for the  
20 fourth calendar quarter of 1994. In computing the use tax under the  
21 preceding sentence, a credit shall be allowed under Part 1  
22 (commencing with Section 6001) for all sales or use tax previously  
23 paid on the lease.

24 (B) For purposes of applying subparagraph (A) only, the  
25 following special rules shall apply:

26 (i) The original cost to the lessor of the qualified property shall  
27 be reduced by the amount of any original cost of that property that  
28 was taken into account by any predecessor lessee in computing the  
29 credit allowable under this section.

30 (ii) Clause (i) shall not apply in any case where the predecessor  
31 lessee was required to recapture the credit provided under this  
32 section pursuant to subdivision (g).

33 (iii) For purposes of this section only, in any case where a  
34 successor lessor has acquired qualified property from a  
35 predecessor lessor in a transaction not treated as a sale under Part  
36 1 (commencing with Section 6001), the original cost to the  
37 successor lessor of the qualified property shall be reduced by the  
38 amount of the original cost of the qualified property that was taken  
39 into account by any lessee of the predecessor lessor in computing  
40 the credit allowable under this section.



(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i), shall be taken into account. In the case of any qualified property constructed, reconstructed, or acquired by a lessor pursuant to a binding contract in existence on or prior to January 1, 1994, the allocation rule specified in subparagraph (A) of paragraph (1) of subdivision (b) shall apply in determining the original cost to the lessor of qualified property.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any party related to the lessee within the meaning of Section 267 or 318 of the Internal Revenue Code) acquires the qualified property from the lessor (or any successor lessor) within one year from the date the qualified property is first used by the lessee under the terms of the lease, the lessee's (or related party's) acquisition of the qualified property from the lessor (or successor lessor) shall be treated as a disposition by the lessee of the qualified property that was subject to the lease under subdivision (g).

(4) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(A) Subparagraph (A) of paragraph (1) of subdivision (b) shall be applied by substituting the term "purchase" for the term "construction, reconstruction, or acquisition."

(B) Subparagraph (C) of paragraph (1) of subdivision (b) shall apply.

(C) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied at the time that either the lessor or the qualified taxpayer pays sales or use tax under Part 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's taxable year in which the credit is allowable to the lessee under this section.

1 (B) The statement required under subparagraph (A) shall be  
2 made available to the Franchise Tax Board upon request.

3 (6) For purposes of this subdivision, in the case of any qualified  
4 taxpayer engaged in those lines of business described in Codes  
5 7371 to 7373, inclusive, of the Standard Industrial Classification  
6 (SIC) Manual published by the United States Office of  
7 Management and Budget, 1987 edition, “the first taxable year  
8 beginning on or after January 1, 1998,” shall be substituted for  
9 “January 1, 1994,” in each place in which it appears. In addition,  
10 “the effective date of this paragraph” shall be substituted for “the  
11 effective date of this clause” and “fourth calendar quarter of  
12 1998” shall be substituted for “fourth calendar quarter of 1994.”

13 (g) No credit shall be allowed if the qualified property is  
14 removed from the state, is disposed of to an unrelated party, or is  
15 used for any purpose not qualifying for the credit provided in this  
16 section in the same taxable year in which the qualified property is  
17 first placed in service in this state. If any qualified property for  
18 which a credit is allowed pursuant to this section is thereafter  
19 removed from this state, disposed of to an unrelated party, or used  
20 for any purpose not qualifying for the credit provided in this  
21 section within one year from the date the qualified property is first  
22 placed in service in this state, the amount of the credit allowed by  
23 this section for that qualified property shall be recaptured by  
24 adding that credit amount to the net tax of the qualified taxpayer  
25 for the taxable year in which the qualified property is disposed of,  
26 removed, or put to an ineligible use.

27 (h) In the case where the credit allowed by this section exceeds  
28 the “net tax,” the excess may be carried over to reduce the “net  
29 tax” in the following year, and succeeding years as follows:

30 (1) Except as provided in paragraph (2), for the seven  
31 succeeding years if necessary, until the credit is exhausted.

32 (2) In the case of a small business, for the nine succeeding  
33 years, if necessary, until the credit is exhausted.

34 (i) (1) This section shall remain in effect until the date  
35 specified in paragraph (2), on which date this section shall cease  
36 to be operative, and as of that date is repealed.

37 (2) This section shall cease to be operative on January 1, 2011.

38 (j) The amendments made by Chapter 954 of the Statutes of  
39 1996 shall be operative for taxable years beginning on or after

1 January 1, 1997, except as provided in paragraph (3) of  
2 subdivision (d).

3 (k) The amendments made by Chapter 323 of the Statutes of  
4 1998 shall be operative for taxable years beginning on or after  
5 January 1, 1998.

6 SEC. 5. Section 17053.51 is added to the Revenue and  
7 Taxation Code, to read:

8 17053.51. (a) A qualified taxpayer shall be allowed a credit  
9 against the “net tax,” as defined in Section 17039, in an amount  
10 equal to the applicable percentage of the qualified cost of qualified  
11 property that is placed in service in this state. For purposes of this  
12 subdivision, the applicable percentage is:

13 (1) Two percent for property placed in service on or after  
14 January 1, 2005, and before January 1, 2006.

15 (2) Three percent for property placed in service on or after  
16 January 1, 2006, and before January 1, 2007.

17 (3) Four percent for property placed in service on or after  
18 January 1, 2007, and before January 1, 2008.

19 (4) Five percent for property placed in service on or after  
20 January 1, 2008, and before January 1, 2009.

21 (5) Six percent for property placed in service on or after  
22 January 1, 2009, and before January 1, 2010.

23 (6) Seven percent for property placed in service on or after  
24 January 1, 2010.

25 (b) (1) For purposes of this section, “qualified cost” means  
26 any cost that satisfies each of the following conditions:

27 (A) Except as otherwise provided in this subparagraph, is a cost  
28 paid or incurred by the qualified taxpayer for the construction,  
29 reconstruction, or acquisition of qualified property on or after  
30 January 1, 2005, and prior to the date this section ceases to be  
31 operative under paragraph (2) of subdivision (i). In the case of any  
32 qualified property constructed, reconstructed, or acquired by the  
33 qualified taxpayer (or any person related to the qualified taxpayer  
34 within the meaning of Section 267 or 707 of the Internal Revenue  
35 Code) pursuant to a binding contract in existence on or prior to  
36 January 1, 2005, costs paid pursuant to that contract shall be  
37 subject to allocation as follows: contract costs shall be allocated to  
38 qualified property based on a ratio of costs actually paid prior to  
39 January 1, 2005, and total contract costs actually paid. “Cost paid”  
40 shall include, without limitation, contractual deposits, and option

1 payments. To the extent of costs allocated, whether or not currently  
2 deductible or depreciable for tax purposes, to a period prior to  
3 January 1, 2005, the cost shall be deemed allocated to property  
4 acquired before January 1, 2005, and is thus not a “qualified cost.”

5 (B) Except as provided in paragraph (3) of subdivision (d) and  
6 subparagraph (B) of paragraph (4) of subdivision (d), is an amount  
7 upon which the qualified taxpayer has paid, directly or indirectly  
8 as a separately stated contract amount or as determined from the  
9 records of the qualified taxpayer, sales or use tax under Part 1  
10 (commencing with Section 6001).

11 (C) Is an amount properly chargeable to the capital account of  
12 the qualified taxpayer.

13 (2) (A) For purposes of this subdivision, any contract entered  
14 into on or after January 1, 2005, that is a successor or replacement  
15 contract to a contract that was binding prior to January 1, 2005,  
16 shall be treated as a binding contract in existence prior to January  
17 1, 2005.

18 (B) If a successor or replacement contract is entered into on or  
19 after January 1, 2005, and the subject of the successor or  
20 replacement contract relates both to amounts for the construction,  
21 reconstruction, or acquisition of qualified property described in  
22 the original binding contract and to costs for the construction,  
23 reconstruction, or acquisition of qualified property not described  
24 in the original binding contract, then the portion of those amounts  
25 described in the successor or replacement contract that were not  
26 described in the original binding contract shall not be treated as  
27 costs paid or incurred pursuant to a binding contract in existence  
28 on or prior to January 1, 2005, under subparagraph (A) of  
29 paragraph (1).

30 (3) (A) For purposes of this section, an option contract in  
31 existence prior to January 1, 2005, under which a qualified  
32 taxpayer (or any other person related to the qualified taxpayer  
33 within the meaning of Section 267 or 707 of the Internal Revenue  
34 Code) had an option to acquire qualified property, shall be treated  
35 as a binding contract under the rules in paragraph (2). For purposes  
36 of this subparagraph, an option contract shall not include an option  
37 under which the optionholder will forfeit an amount less than 10  
38 percent of the fixed option price in the event the option is not  
39 exercised.

1 (B) For purposes of this section, a contract shall be treated as  
2 binding even if the contract is subject to a condition.

3 (c) (1) For purposes of this section, “qualified taxpayer”  
4 means any taxpayer that is both of the following:

5 (A) Engaged in those lines of business described in Codes 2011  
6 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the  
7 Standard Industrial Classification (SIC) Manual published by the  
8 United States Office of Management and Budget, 1987 edition.

9 (B) Certified, in the form and manner prescribed by the State  
10 Department of Education, as a qualified participant in the Career  
11 Technical Education Campaign pursuant to Section 52337 of the  
12 Education Code for the taxable year for which a credit is claimed  
13 under this section.

14 (2) In the case of any passthrough entity, the determination of  
15 whether a taxpayer is a qualified taxpayer shall be made at the  
16 entity level and any credit under this section or Section 23651 shall  
17 be allowed to the passthrough entity and passed through to the  
18 partners or shareholders in accordance with applicable provisions  
19 of this part or Part 11 (commencing with Section 23001). For  
20 purposes of this paragraph, the term “passthrough entity” means  
21 any partnership or S corporation.

22 (3) The Franchise Tax Board may prescribe regulations to carry  
23 out the purposes of this section, including any regulations  
24 necessary to prevent the avoidance of the effect of this section  
25 through splitups, shell corporations, partnerships, tiered  
26 ownership structures, sale-leaseback transactions, or otherwise.

27 (d) For purposes of this section, “qualified property” means  
28 property that is described as any of the following:

29 (1) Tangible personal property that is defined in Section  
30 1245(a) of the Internal Revenue Code for use by a qualified  
31 taxpayer in those lines of business described in Codes 2011 to  
32 3999, inclusive, of the Standard Industrial Classification (SIC)  
33 Manual published by the United States Office of Management and  
34 Budget, 1987 edition, that is primarily used for any of the  
35 following:

36 (A) For the manufacturing, processing, refining, fabricating, or  
37 recycling of property, beginning at the point at which any raw  
38 materials are received by the qualified taxpayer and introduced  
39 into the process and ending at the point at which the  
40 manufacturing, processing, refining, fabricating, or recycling has

1 altered tangible personal property to its completed form, including  
2 packaging, if required.

3 (B) In research and development.

4 (C) To maintain, repair, measure, or test any property described  
5 in this paragraph.

6 (D) For pollution control that meets or exceeds standards  
7 established by the state or by any local or regional governmental  
8 agency within the state.

9 (E) For recycling.

10 (2) Computers and computer peripheral equipment, as defined  
11 in Section 168(i)(2)(B) of the Internal Revenue Code, that is  
12 tangible personal property as defined in Section 1245(a) of the  
13 Internal Revenue Code for use by a qualified taxpayer in those  
14 lines of business described in SIC Codes 7371 to 7373, inclusive,  
15 of the SIC Manual, 1987 edition, that is primarily used to develop  
16 or manufacture prepackaged software or custom software  
17 prepared to the special order of the purchaser who uses the  
18 program to produce and sell or license copies of the program as  
19 prepackaged software.

20 (3) The value of any capitalized labor costs that are directly  
21 allocable to the construction or modification of property described  
22 in paragraph (1) or (2).

23 (4) In the case of any qualified taxpayer engaged in  
24 manufacturing activities described in SIC Code 357 or 367, those  
25 activities related to biotechnology described in SIC Code 8731,  
26 those activities related to biopharmaceutical establishments only  
27 that are described in SIC Codes 2833 to 2836, inclusive, those  
28 activities related to space vehicles and parts described in SIC  
29 Codes 3761 to 3769, inclusive, those activities related to space  
30 satellites and communications satellites and equipment described  
31 in SIC Codes 3663 and 3812, or those activities related to  
32 semiconductor equipment manufacturing described in SIC Code  
33 3559, “qualified property” also includes the following:

34 (A) Special purpose buildings and foundations that are  
35 constructed or modified for use by the qualified taxpayer primarily  
36 in a manufacturing, processing, refining, or fabricating process, or  
37 as a research or storage facility primarily used in connection with  
38 a manufacturing process.

39 (B) The value of any capitalized labor costs that are directly  
40 allocable to the construction or modification of special purpose



1 buildings and foundations that are used primarily in the  
2 manufacturing, processing, refining, or fabricating process, or as  
3 a research or storage facility primarily used in connection with a  
4 manufacturing process.

5 (C) (i) For purposes of this paragraph, “special purpose  
6 building and foundation” means only a building and the  
7 foundation immediately underlying the building that is  
8 specifically designed and constructed or reconstructed for the  
9 installation, operation, and use of specific machinery and  
10 equipment with a special purpose, which machinery and  
11 equipment, after installation, will become affixed to or a fixture of  
12 the real property, and the construction or reconstruction of which  
13 is specifically designed and used exclusively for the specified  
14 purposes as set forth in subparagraph (A).

15 (ii) A building is specifically designed and constructed or  
16 modified for a qualified purpose if it is not economical to design  
17 and construct the building for the intended purpose and then use  
18 the structure for a different purpose.

19 (iii) For purposes of clause (i) and clause (vi), a building is used  
20 exclusively for a qualified purpose only if its use does not include  
21 a use for which it was not specifically designed and constructed or  
22 modified. Incidental use of a building for nonqualified purposes  
23 does not preclude the building from being a special purpose  
24 building. “Incidental use” means a use which is both related and  
25 subordinate to the qualified purpose. It will be conclusively  
26 presumed that a use is not subordinate if more than one-third of the  
27 total usable volume of the building is devoted to a use which is not  
28 a qualified purpose.

29 (iv) In the event an entire building does not qualify as a special  
30 purpose building, a taxpayer may establish that a portion of a  
31 building, and the foundation immediately underlying the portion,  
32 qualifies for treatment as a special purpose building and  
33 foundation if the portion satisfies all of the definitional provisions  
34 in this subparagraph.

35 (v) To the extent that a building is not a special purpose  
36 building as defined above, but a portion of the building qualifies  
37 for treatment as a special purpose building, then all equipment  
38 which exclusively supports the qualified purpose occurring within  
39 that portion and which would qualify as Section 1245 of the  
40 Internal Revenue Code property if it were not a fixture or affixed



1 to the building shall be treated as a cost of the portion of the  
2 building which qualifies for treatment as a special purpose  
3 building.

4 (vi) Buildings and foundations which do not meet the  
5 definition of a special purpose building and foundation set forth  
6 above include, but are not limited to: buildings designed and  
7 constructed or reconstructed principally to function as a general  
8 purpose manufacturing, industrial, or commercial building;  
9 research facilities that are used primarily prior to or after, or prior  
10 to and after, the manufacturing process; or storage facilities that  
11 are used primarily prior to or after, or prior to and after, completion  
12 of the manufacturing process. A research facility shall not be  
13 considered to be used primarily prior to or after, or prior to and  
14 after, the manufacturing process if its purpose and use relate  
15 exclusively to the development and regulatory approval of the  
16 manufacturing process for specific biopharmaceutical products. A  
17 research facility which is used primarily in connection with the  
18 discovery of an organism from which a biopharmaceutical product  
19 or process is developed does not meet the requirements of the  
20 preceding sentence.

21 (5) Subject to the provisions in subparagraph (B) of paragraph  
22 (1) of subdivision (b), qualified property also includes computer  
23 software that is primarily used for those purposes set forth in  
24 paragraph (1) or (2) of this subdivision.

25 (6) Qualified property does not include any of the following:

26 (A) Furniture.

27 (B) Facilities used for warehousing purposes after completion  
28 of the manufacturing process.

29 (C) Inventory.

30 (D) Equipment used in the extraction process.

31 (E) Equipment used to store finished products that have  
32 completed the manufacturing process.

33 (F) Any tangible personal property that is used in  
34 administration, general management, or marketing.

35 (e) For purposes of this section:

36 (1) "Biopharmaceutical activities" means those activities that  
37 use organisms or materials derived from organisms, and their  
38 cellular, subcellular, or molecular components, in order to provide  
39 pharmaceutical products for human or animal therapeutics and  
40 diagnostics. Biopharmaceutical activities make use of living

1 organisms to make commercial products, as opposed to  
2 pharmaceutical activities which make use of chemical compounds  
3 to produce commercial products.

4 (2) “Fabricating” means to make, build, create, produce, or  
5 assemble components or property to work in a new or different  
6 manner.

7 (3) “Manufacturing” means the activity of converting or  
8 conditioning property by changing the form, composition, quality,  
9 or character of the property for ultimate sale at retail or use in the  
10 manufacturing of a product to be ultimately sold at retail.  
11 Manufacturing includes any improvements to tangible personal  
12 property that result in a greater service life or greater functionality  
13 than that of the original property.

14 (4) “Other biotechnology activities” means activities  
15 consisting of the application of recombinant DNA technology to  
16 produce commercial products, as well as activities regarding  
17 pharmaceutical delivery systems designed to provide a measure of  
18 control over the rate, duration, and site of pharmaceutical delivery.

19 (5) “Primarily” means tangible personal property used 50  
20 percent or more of the time in an activity described in subdivision  
21 (d).

22 (6) “Process” means the period beginning at the point at which  
23 any raw materials are received by the qualified taxpayer and  
24 introduced into the manufacturing, processing, refining,  
25 fabricating, or recycling activity of the qualified taxpayer and  
26 ending at the point at which the manufacturing, processing,  
27 refining, fabricating, or recycling activity of the qualified taxpayer  
28 has altered tangible personal property to its completed form,  
29 including packaging, if required. Raw materials shall be  
30 considered to have been introduced into the process when the raw  
31 materials are stored on the same premises where the qualified  
32 taxpayer’s manufacturing, processing, refining, fabricating, or  
33 recycling activity is conducted. Raw materials that are stored on  
34 premises other than where the qualified taxpayer’s manufacturing,  
35 processing, refining, fabricating, or recycling activity is  
36 conducted, shall not be considered to have been introduced into the  
37 manufacturing, processing, refining, fabricating, or recycling  
38 process.

(7) “Processing” means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) “Refining” means the process of converting a natural resource to an intermediate or finished product.

(9) “Research and development” means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) “Small business” means a qualified taxpayer that meets any of the following requirements during the income year for which the credit is allowed:

(A) Has gross receipts of less than fifty million dollars (\$50,000,000).

(B) Has net assets of less than fifty million dollars (\$50,000,000).

(C) Has a total credit of less than one million dollars (\$1,000,000).

(D) Is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the SIC Manual published by the United States Office of Management and Budget, 1987 edition, and has not received regulatory approval for any product from the United States Food and Drug Administration.

(f) The credit allowed under subdivision (a) shall apply to qualified property that is acquired by, or subject to lease, by a qualified taxpayer, subject to the following special rules:

(1) A lessor of qualified property, irrespective of whether the lessor is a qualified taxpayer, shall not be allowed the credit provided under subdivision (a) with respect to any qualified property leased to another qualified taxpayer.

(2) For purposes of paragraphs (2) and (3) of subdivision (b), “binding contract” shall include any lease agreement with respect to the qualified property.

(3) (A) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is not treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(i) Except as provided by subparagraph (C) of this paragraph, subparagraphs (A) and (C) of paragraph (1) of subdivision (b) shall not apply.

1 (ii) Except as provided in subparagraph (B) and clause (iii), the  
2 “qualified cost” upon which the lessee shall compute the credit  
3 provided under this section shall be equal to the original cost to the  
4 lessor (within the meaning of Section 18031) of the qualified  
5 property that is the subject of the lease.

6 (iii) The requirement of subparagraph (B) of paragraph (1) of  
7 subdivision (b) shall be treated as satisfied only if the lessor has  
8 made a timely election under either Section 6094.1 or subdivision  
9 (d) of Section 6244 and has paid sales tax reimbursement or use  
10 tax measured by the purchase price of the qualified property  
11 (within the meaning of paragraph (5) of subdivision (g) of Section  
12 6006). For purposes of this subdivision, the amount of original  
13 cost to the lessor which may be taken into account under clause (ii)  
14 shall not exceed the purchase price upon which sales tax  
15 reimbursement or use tax has been paid under the preceding  
16 sentence.

17 (iv) With respect to leases entered into between January 1,  
18 2005, and the effective date of this clause, the lessor may elect to  
19 pay use tax measured by the purchase price of the property by  
20 reporting and paying the tax with the return of the lessor for the  
21 fourth calendar quarter of 2005. In computing the use tax under the  
22 preceding sentence, a credit shall be allowed under Part 1  
23 (commencing with Section 6001) for all sales or use tax previously  
24 paid on the lease.

25 (B) For purposes of applying subparagraph (A) only, the  
26 following special rules shall apply:

27 (i) The original cost to the lessor of the qualified property shall  
28 be reduced by the amount of any original cost of that property that  
29 was taken into account by any predecessor lessee in computing the  
30 credit allowable under this section.

31 (ii) Clause (i) shall not apply in any case where the predecessor  
32 lessee was required to recapture the credit provided under this  
33 section pursuant to subdivision (g).

34 (iii) For purposes of this section only, in any case where a  
35 successor lessor has acquired qualified property from a  
36 predecessor lessor in a transaction not treated as a sale under Part  
37 1 (commencing with Section 6001), the original cost to the  
38 successor lessor of the qualified property shall be reduced by the  
39 amount of the original cost of the qualified property that was taken

1 into account by any lessee of the predecessor lessor in computing  
2 the credit allowable under this section.

3 (C) In determining the original cost of any qualified property  
4 under this paragraph, only amounts paid or incurred by the lessor  
5 on or after January 1, 2005, and prior to the date this section ceases  
6 to be operative under paragraph (2) of subdivision (i), shall be  
7 taken into account. In the case of any qualified property  
8 constructed, reconstructed, or acquired by a lessor pursuant to a  
9 binding contract in existence on or prior to January 1, 2005, the  
10 allocation rule specified in subparagraph (A) of paragraph (1) of  
11 subdivision (b) shall apply in determining the original cost to the  
12 lessor of qualified property.

13 (D) Notwithstanding subparagraph (A), in the case of any  
14 leasing transaction for which the lessee is allowed the credit under  
15 this section and thereafter the lessee (or any party related to the  
16 lessee within the meaning of Section 267 or 318 of the Internal  
17 Revenue Code) acquires the qualified property from the lessor (or  
18 any successor lessor), within one year from the date the qualified  
19 property is first used by the lessee under the terms of the lease, the  
20 lessee's (or related party's) acquisition of the qualified property  
21 from the lessor (or successor lessor) shall be treated as a  
22 disposition by the lessee of the qualified property that was subject  
23 to the lease under subdivision (g).

24 (4) For purposes of determining the qualified cost paid or  
25 incurred by a lessee in any leasing transaction that is treated as a  
26 sale under Part 1 (commencing with Section 6001), the following  
27 rules shall apply:

28 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall  
29 be applied by substituting the term "purchase" for the term  
30 "construction, reconstruction, or acquisition."

31 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall  
32 apply.

33 (C) The requirement of subparagraph (B) of paragraph (1) of  
34 subdivision (b) shall be treated as satisfied at the time that either  
35 the lessor or the qualified taxpayer pays sales or use tax under Part  
36 1 (commencing with Section 6001).

37 (5) (A) In the case of any leasing transaction described in  
38 paragraph (3), the lessor shall provide a statement to the lessee  
39 specifying the amount of the lessor's original cost of the qualified  
40 property and the amount of that cost upon which a sales or use tax

1 was paid within 45 days after the close of the lessee's taxable year  
2 in which the credit is allowable to the lessee under this section.

3 (B) The statement required under subparagraph (A) shall be  
4 made available to the Franchise Tax Board upon request.

5 (g) No credit shall be allowed if the qualified property is  
6 removed from the state, is disposed of to an unrelated party, or is  
7 used for any purpose not qualifying for the credit provided in this  
8 section in the same taxable year in which the qualified property is  
9 first placed in service in this state. If any qualified property for  
10 which a credit is allowed pursuant to this section is thereafter  
11 removed from this state, disposed of to an unrelated party, or used  
12 for any purpose not qualifying for the credit provided in this  
13 section within one year from the date the qualified property is first  
14 placed in service in this state, the amount of the credit allowed by  
15 this section for that qualified property shall be recaptured by  
16 adding that credit amount to the net tax of the qualified taxpayer  
17 for the taxable year in which the qualified property is disposed of,  
18 removed, or put to an ineligible use.

19 (h) In the case where the credit allowed by this section exceeds  
20 the "net tax," the excess may be carried over to reduce the "net  
21 tax" in the following year, and succeeding years as follows:

22 (1) Except as provided in paragraph (2), for the seven  
23 succeeding years if necessary, until the credit is exhausted.

24 (2) In the case of a small business, for the nine succeeding  
25 years, if necessary, until the credit is exhausted.

26 (i) *The credit under this section shall be known as the "Career*  
27 *Technical Education Campaign" credit or as the "CTEC" credit.*

28 (j) This section shall become operative on January 1, 2005, and  
29 remain in effect only until January 1, 2012, and as of that date is  
30 repealed.

31 SEC. 6. Section 23036 of the Revenue and Taxation Code is  
32 amended to read:

33 23036. (a) (1) The term "tax" includes any of the following:

34 (A) The tax imposed under Chapter 2 (commencing with  
35 Section 23101).

36 (B) The tax imposed under Chapter 3 (commencing with  
37 Section 23501).

38 (C) The tax on unrelated business taxable income, imposed  
39 under Section 23731.

40 (D) The tax on S corporations imposed under Section 23802.

(2) The term “tax” does not include any amount imposed under paragraph (1) of subdivision (e) of Section 24667 or paragraph (2) of subdivision (f) of Section 24667.

(b) For purposes of Article 5 (commencing with Section 18661) of Chapter 2, Article 3 (commencing with Section 19031) of Chapter 4, Article 6 (commencing with Section 19101) of Chapter 4, and Chapter 7 (commencing with Section 19501) of Part 10.2, and for purposes of Sections 18601, 19001, and 19005, the term “tax” shall also include all of the following:

(1) The tax on limited partnerships, imposed under Section 17935 or Section 23081, the tax on limited liability companies, imposed under Section 17941 or Section 23091, and the tax on registered limited liability partnerships and foreign limited liability partnerships imposed under Section 17948 or Section 23097.

(2) The alternative minimum tax imposed under Chapter 2.5 (commencing with Section 23400).

(3) The tax on built-in gains of S corporations, imposed under Section 23809.

(4) The tax on excess passive investment income of S corporations, imposed under Section 23811.

(c) Notwithstanding any other provision of this part, credits shall be allowed against the “tax” in the following order:

(1) Credits that do not contain carryover provisions.

(2) Credits that, when the credit exceeds the “tax,” allow the excess to be carried over to offset the “tax” in succeeding taxable years, except for those credits that are allowed to reduce the “tax” below the tentative minimum tax, as defined by Section 23455. The order of credits within this paragraph shall be determined by the Franchise Tax Board.

(3) The minimum tax credit allowed by Section 23453.

(4) Credits that are allowed to reduce the “tax” below the tentative minimum tax, as defined by Section 23455.

(5) Credits for taxes withheld under Section 18662.

(d) Notwithstanding any other provision of this part, each of the following shall be applicable:

(1) No credit shall reduce the “tax” below the tentative minimum tax (as defined by paragraph (1) of subdivision (a) of Section 23455), except the following credits:



1 (A) The credit allowed by former Section 23601 (relating to  
2 solar energy).

3 (B) The credit allowed by former Section 23601.4 (relating to  
4 solar energy).

5 (C) The credit allowed by Section 23601.5 (relating to solar  
6 energy).

7 (D) The credit allowed by Section 23609 (relating to research  
8 expenditures).

9 (E) The credit allowed by Section 23609.5 (relating to clinical  
10 testing expenses).

11 (F) The credit allowed by Section 23610.5 (relating to  
12 low-income housing).

13 (G) The credit allowed by former Section 23612 (relating to  
14 sales and use tax credit).

15 (H) The credit allowed by Section 23612.2 (relating to  
16 enterprise zone sales or use tax credit).

17 (I) The credit allowed by Section 23612.6 (relating to Los  
18 Angeles Revitalization Zone sales tax credit).

19 (J) The credit allowed by former Section 23622 (relating to  
20 enterprise zone hiring credit).

21 (K) The credit allowed by Section 23622.7 (relating to  
22 enterprise zone hiring credit).

23 (L) The credit allowed by former Section 23623 (relating to  
24 program area hiring credit).

25 (M) For each taxable year beginning on or after January 1,  
26 1994, the credit allowed by Section 23623.5 (relating to Los  
27 Angeles Revitalization Zone hiring credit).

28 (N) The credit allowed by Section 23625 (relating to Los  
29 Angeles Revitalization Zone hiring credit).

30 (O) The credit allowed by Section 23633 (relating to targeted  
31 tax area sales or use tax credit).

32 (P) The credit allowed by Section 23634 (relating to targeted  
33 tax area hiring credit).

34 (Q) The credit allowed by Section 23649 (relating to qualified  
35 property).

36 (R) The credit allowed by Section 23651 (relating to career  
37 technical education campaign).

38 (2) No credit against the tax shall reduce the minimum  
39 franchise tax imposed under Chapter 2 (commencing with Section  
40 23101).

1 (e) Any credit which is partially or totally denied under  
2 subdivision (d) shall be allowed to be carried over to reduce the  
3 “tax” in the following year, and succeeding years if necessary, if  
4 the provisions relating to that credit include a provision to allow  
5 a carryover of the unused portion of that credit.

6 (f) Unless otherwise provided, any remaining carryover from  
7 a credit that has been repealed or made inoperative shall continue  
8 to be allowed to be carried over under the provisions of that section  
9 as it read immediately prior to being repealed or becoming  
10 inoperative.

11 (g) Unless otherwise provided, if two or more taxpayers share  
12 in costs that would be eligible for a tax credit allowed under this  
13 part, each taxpayer shall be eligible to receive the tax credit in  
14 proportion to its respective share of the costs paid or incurred.

15 (h) Unless otherwise provided, in the case of an S corporation,  
16 any credit allowed by this part shall be computed at the S  
17 corporation level, and any limitation on the expenses qualifying  
18 for the credit or limitation upon the amount of the credit shall be  
19 applied to the S corporation and to each shareholder.

20 (i) (1) With respect to any taxpayer that directly or indirectly  
21 owns an interest in a business entity that is disregarded for tax  
22 purposes pursuant to Section 23038 and any regulations  
23 thereunder, the amount of any credit or credit carryforward  
24 allowable for any taxable year attributable to the disregarded  
25 business entity shall be limited in accordance with paragraphs (2)  
26 and (3).

27 (2) The amount of any credit otherwise allowed under this part,  
28 including any credit carryover from prior years, that may be  
29 applied to reduce the taxpayer’s “tax,” as defined in subdivision  
30 (a), for the taxable year shall be limited to an amount equal to the  
31 excess of the taxpayer’s regular tax (as defined in Section 23455),  
32 determined by including income attributable to the disregarded  
33 business entity that generated the credit or credit carryover, over  
34 the taxpayer’s regular tax (as defined in Section 23455),  
35 determined by excluding the income attributable to that  
36 disregarded business entity. No credit shall be allowed if the  
37 taxpayer’s regular tax (as defined in Section 23455), determined  
38 by including the income attributable to the disregarded business  
39 entity is less than the taxpayer’s regular tax (as defined in Section

23455), determined by excluding the income attributable to the disregarded business entity.

(3) If the amount of a credit allowed pursuant to the section establishing the credit exceeds the amount allowable under this subdivision in any taxable year, the excess amount may be carried over to subsequent taxable years pursuant to subdivisions (d), (e), and (f).

(j) (1) Unless otherwise specifically provided, in the case of a taxpayer that is a partner or shareholder of an eligible pass-through entity described in paragraph (2), any credit passed through to the taxpayer in the taxpayer's first taxable year beginning on or after the date the credit is no longer operative may be claimed by the taxpayer in that taxable year, notwithstanding the repeal of the statute authorizing the credit prior to the close of that taxable year.

(2) For purposes of this subdivision, "eligible pass-through entity" means any partnership or S corporation that files its return on a fiscal year basis pursuant to Section 18566, and that is entitled to a credit pursuant to this part for the taxable year that begins during the last year a credit is operative.

(3) This subdivision shall apply to credits that become inoperative on or after the operative date of the act adding this subdivision.

SEC. 7. Section 23649 of the Revenue and Taxation Code is amended to read:

23649. (a) (1) A qualified taxpayer shall be allowed a credit against the "tax," as defined in Section 23036, equal to the applicable percentage of the qualified cost of qualified property that is placed in service in this state. For purposes of this subdivision the applicable percentage is:

(A) Six percent for property placed in service before January 1, 2005.

(B) Five percent for property placed in service on or after January 1, 2005, and before January 1, 2006.

(C) Four percent for property placed in service on or after January 1, 2006, and before January 1, 2007.

(D) Three percent for property placed in service on or after January 1, 2007, and before January 1, 2008.

(E) Two percent for property placed in service on or after January 1, 2008, and before January 1, 2009.

1 (F) One percent for property placed in service on or after  
2 January 1, 2009, and before January 1, 2010.

3 (2) In the case of any qualified costs paid or incurred on or after  
4 January 1, 1994, and prior to the first taxable year of the qualified  
5 taxpayer beginning on or after January 1, 1995, the credit provided  
6 under paragraph (1) shall be claimed by the qualified taxpayer on  
7 the qualified taxpayer's return for the first taxable year beginning  
8 on or after January 1, 1995. No credit shall be claimed under this  
9 section on a return filed for any taxable year commencing prior to  
10 the qualified taxpayer's first taxable year beginning on or after  
11 January 1, 1995.

12 (b) (1) For purposes of this section, "qualified cost" means  
13 any cost that satisfies each of the following conditions:

14 (A) Except as otherwise provided in this subparagraph, is a cost  
15 paid or incurred by the qualified taxpayer for the construction,  
16 reconstruction, or acquisition of qualified property on or after  
17 January 1, 1994, and prior to the date this section ceases to be  
18 operative under paragraph (2) of subdivision (i). In the case of any  
19 qualified property constructed, reconstructed, or acquired by the  
20 qualified taxpayer (or any person related to the qualified taxpayer  
21 within the meaning of Section 267 or 707 of the Internal Revenue  
22 Code) pursuant to a binding contract in existence on or prior to  
23 January 1, 1994, costs paid pursuant to that contract shall be  
24 subject to allocation as follows: contract costs shall be allocated to  
25 qualified property based on a ratio of costs actually paid prior to  
26 January 1, 1994, and total contract costs actually paid. "Cost paid"  
27 shall include, without limitation, contractual deposits and option  
28 payments. To the extent of cost allocated, whether or not currently  
29 deductible or depreciable for tax purposes, to a period prior to  
30 January 1, 1994, the cost shall be deemed allocated to property  
31 acquired before January 1, 1994, and is thus not a "qualified cost."

32 (B) Except as provided in paragraph (3) of subdivision (d) and  
33 subparagraph (B) of paragraph (4) of subdivision (d), is an amount  
34 upon which the qualified taxpayer has paid, directly or indirectly  
35 as a separately stated contract amount or as determined from the  
36 records of the qualified taxpayer, sales or use tax under Part 1  
37 (commencing with Section 6001).

38 (C) Is an amount properly chargeable to the capital account of  
39 the qualified taxpayer.

1 (2) (A) For purposes of this subdivision, any contract entered  
2 into on or after January 1, 1994, that is a successor or replacement  
3 contract to a contract that was binding prior to January 1, 1994,  
4 shall be treated as a binding contract in existence prior to January  
5 1, 1994.

6 (B) If a successor or replacement contract is entered into on or  
7 after January 1, 1994, and the subject of the successor or  
8 replacement contract relates both to amounts for the construction,  
9 reconstruction, or acquisition of qualified property described in  
10 the original binding contract and to costs for the construction,  
11 reconstruction, or acquisition of qualified property not described  
12 in the original binding contract, then the portion of those amounts  
13 described in the successor or replacement contract that were not  
14 described in the original binding contract shall not be treated as  
15 costs paid or incurred pursuant to a binding contract in existence  
16 on or prior to January 1, 1994, under subparagraph (A) of  
17 paragraph (1).

18 (3) (A) For purposes of this section, an option contract in  
19 existence prior to January 1, 1994, under which a qualified  
20 taxpayer (or any other person related to the qualified taxpayer  
21 within the meaning of Section 267 or 707 of the Internal Revenue  
22 Code) had an option to acquire qualified property, shall be treated  
23 as a binding contract under the rules in paragraph (2). For purposes  
24 of this subparagraph, an option contract shall not include an option  
25 under which the optionholder will forfeit an amount less than 10  
26 percent of the fixed option price in the event the option is not  
27 exercised.

28 (B) For purposes of this section, a contract shall be treated as  
29 binding even if the contract is subject to a condition.

30 (4) For purposes of this subdivision, in the case of any qualified  
31 taxpayer engaged in those lines of business described in Codes  
32 7371 to 7373, inclusive, of the Standard Industrial Classification  
33 (SIC) Manual published by the United States Office of  
34 Management and Budget, 1987 edition, “the first taxable year  
35 beginning on or after January 1, 1998,” shall be substituted for  
36 “January 1, 1994,” in each place in which it appears.

37 (c) (1) For purposes of this section, “qualified taxpayer”  
38 means any taxpayer engaged in those lines of business described  
39 in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373,  
40 inclusive, of the Standard Industrial Classification (SIC) Manual

1 published by the United States Office of Management and Budget,  
2 1987 edition.

3 (2) In the case of any passthrough entity, the determination of  
4 whether a taxpayer is a qualified taxpayer shall be made at the  
5 entity level and any credit under this section or Section 17053.49  
6 shall be allowed to the passthrough entity and passed through to  
7 the partners or shareholders in accordance with applicable  
8 provisions of Part 10 (commencing with Section 17001) or Part 11  
9 (commencing with Section 23001). For purposes of this  
10 paragraph, the term “passthrough entity” means any partnership  
11 or S corporation.

12 (3) The Franchise Tax Board may prescribe regulations to carry  
13 out the purposes of this section, including any regulations  
14 necessary to prevent the avoidance of the effect of this section  
15 through splitups, shell corporations, partnerships, tiered  
16 ownership structures, sale-leaseback transactions, or otherwise.

17 (d) For purposes of this section, “qualified property” means  
18 property that is described as either of the following:

19 (1) Tangible personal property that is defined in Section  
20 1245(a) of the Internal Revenue Code for use by a qualified  
21 taxpayer in those lines of business described in Codes 2011 to  
22 3999, inclusive, of the Standard Industrial Classification (SIC)  
23 Manual published by the United States Office of Management and  
24 Budget, 1987 edition, that is primarily used for any of the  
25 following:

26 (A) For the manufacturing, processing, refining, fabricating, or  
27 recycling of property, beginning at the point at which any raw  
28 materials are received by the qualified taxpayer and introduced  
29 into the process and ending at the point at which the  
30 manufacturing, processing, refining, fabricating, or recycling has  
31 altered tangible personal property to its completed form, including  
32 packaging, if required.

33 (B) In research and development.

34 (C) To maintain, repair, measure, or test any property described  
35 in this paragraph.

36 (D) For pollution control that meets or exceeds standards  
37 established by the state or by any local or regional governmental  
38 agency within the state.

39 (E) For recycling.

(2) Computers and computer peripheral equipment, as defined in Section 168(i)(2)(B) of the Internal Revenue Code, that is tangible personal property as defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in SIC Codes 7371 to 7373, inclusive, of the SIC Manual, 1987 edition, that is primarily used to develop or manufacture prepackaged software or custom software prepared to the special order of the purchaser who uses the program to produce and sell or license copies of the program as prepackaged software.

(3) The value of any capitalized labor costs that are directly allocable to the construction or modification of property described in paragraph (1) or (2).

(4) In the case of any qualified taxpayer engaged in manufacturing activities described in SIC Code 357 or 367, those activities related to biotechnology described in SIC Code 8731, those activities related to biopharmaceutical establishments only that are described in SIC Codes 2833 to 2836, inclusive, those activities related to space vehicles and parts described in SIC Codes 3761 to 3769, inclusive, those activities related to space satellites and communications satellites and equipment described in SIC Codes 3663 and 3812 (but only with respect to “qualified property” that is placed in service on or after January 1, 1996), or those activities related to semiconductor equipment manufacturing described in SIC Code 3559 (but only with respect to “qualified property” that is placed in service on or after January 1, 1997), “qualified property” also includes the following:

(A) Special purpose buildings and foundations that are constructed or modified for use by the qualified taxpayer primarily in a manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(B) The value of any capitalized labor costs that are directly allocable to the construction or modification of special purpose buildings and foundations that are used primarily in the manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(C) (i) For purposes of this paragraph, “special purpose building and foundation” means only a building and the



1 foundation immediately underlying the building that is  
2 specifically designed and constructed or reconstructed for the  
3 installation, operation, and use of specific machinery and  
4 equipment with a special purpose, which machinery and  
5 equipment, after installation, will become affixed to or a fixture of  
6 the real property, and the construction or reconstruction of which  
7 is specifically designed and used exclusively for the specified  
8 purposes as set forth in subparagraph (A) (“qualified purpose”).

9 (ii) A building is specifically designed and constructed or  
10 modified for a qualified purpose if it is not economical to design  
11 and construct the building for the intended purpose and then use  
12 the structure for a different purpose.

13 (iii) For purposes of clause (i) and clause (vi), a building is used  
14 exclusively for a qualified purpose only if its use does not include  
15 a use for which it was not specifically designed and constructed or  
16 modified. Incidental use of a building for nonqualified purposes  
17 does not preclude the building from being a special purpose  
18 building. “Incidental use” means a use which is both related and  
19 subordinate to the qualified purpose. It will be conclusively  
20 presumed that a use is not subordinate if more than one-third of the  
21 total usable volume of the building is devoted to a use which is not  
22 a qualified purpose.

23 (iv) In the event an entire building does not qualify as a special  
24 purpose building, a taxpayer may establish that a portion of a  
25 building, and the foundation immediately underlying the portion,  
26 qualifies for treatment as a special purpose building and  
27 foundation if the portion satisfies all of the definitional provisions  
28 in this subparagraph.

29 (v) To the extent that a building is not a special purpose  
30 building as defined above, but a portion of the building qualifies  
31 for treatment as a special purpose building, then all equipment  
32 which exclusively supports the qualified purpose occurring within  
33 that portion and which would qualify as Internal Revenue Code  
34 Section 1245 property if it were not a fixture or affixed to the  
35 building shall be treated as a cost of the portion of the building  
36 which qualifies for treatment as a special purpose building.

37 (vi) Buildings and foundations which do not meet the  
38 definition of a special purpose building and foundation set forth  
39 above include, but are not limited to: buildings designed and  
40 constructed or reconstructed principally to function as a general

1 purpose manufacturing, industrial, or commercial building;  
2 research facilities that are used primarily prior to or after, or prior  
3 to and after, the manufacturing process; or storage facilities that  
4 are used primarily prior to or after, or prior to and after, completion  
5 of the manufacturing process. A research facility shall not be  
6 considered to be used primarily prior to or after, or prior to and  
7 after, the manufacturing process if its purpose and use relate  
8 exclusively to the development and regulatory approval of the  
9 manufacturing process for specific biopharmaceutical products. A  
10 research facility which is used primarily in connection with the  
11 discovery of an organism from which a biopharmaceutical product  
12 or process is developed does not meet the requirements of the  
13 preceding sentence.

14 (5) Subject to the provisions in subparagraph (B) of paragraph  
15 (1) of subdivision (b), qualified property also includes computer  
16 software that is primarily used for those purposes set forth in  
17 paragraph (1) or (2) of this subdivision.

18 (6) Qualified property does not include any of the following:

19 (A) Furniture.

20 (B) Facilities used for warehousing purposes after completion  
21 of the manufacturing process.

22 (C) Inventory.

23 (D) Equipment used in the extraction process.

24 (E) Equipment used to store finished products that have  
25 completed the manufacturing process.

26 (F) Any tangible personal property that is used in  
27 administration, general management, or marketing.

28 (G) Any vehicle for which a credit is claimed pursuant to  
29 Section 17052.11 or 23603.

30 (e) For purposes of this section:

31 (1) "Biopharmaceutical activities" means those activities that  
32 use organisms or materials derived from organisms, and their  
33 cellular, subcellular, or molecular components, in order to provide  
34 pharmaceutical products for human or animal therapeutics and  
35 diagnostics. Biopharmaceutical activities make use of living  
36 organisms to make commercial products, as opposed to  
37 pharmaceutical activities which make use of chemical compounds  
38 to produce commercial products.

(2) “Fabricating” means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(3) “Manufacturing” means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(4) “Other biotechnology activities” means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(5) “Primarily” means tangible personal property used 50 percent or more of the time in an activity described in subdivision (d).

(6) “Process” means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified person and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer’s manufacturing, processing, refining, fabricating, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer’s manufacturing, processing, refining, fabricating, or recycling activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) “Processing” means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) “Refining” means the process of converting a natural resource to an intermediate or finished product.

1 (9) “Research and development” means those activities that  
2 are described in Section 174 of the Internal Revenue Code or in any  
3 regulations thereunder.

4 (10) “Small business” means a qualified taxpayer that meets  
5 any of the following requirements during the taxable year for  
6 which the credit is allowed:

7 (A) Has gross receipts of less than fifty million dollars  
8 (\$50,000,000).

9 (B) Has net assets of less than fifty million dollars  
10 (\$50,000,000).

11 (C) Has a total credit of less than one million dollars  
12 (\$1,000,000).

13 (D) For taxable years beginning on or after January 1, 1997, is  
14 engaged in biopharmaceutical activities or other biotechnology  
15 activities that are described in Codes 2833 to 2836, inclusive, of  
16 the Standard Industrial Classification (SIC) Manual published by  
17 the United States Office of Management and Budget, 1987 edition,  
18 and has not received regulatory approval for any product from the  
19 United States Food and Drug Administration.

20 (f) The credit allowed under subdivision (a) shall apply to  
21 qualified property that is acquired by or subject to lease by a  
22 qualified taxpayer, subject to the following special rules:

23 (1) A lessor of qualified property, irrespective of whether the  
24 lessor is a qualified taxpayer, shall not be allowed the credit  
25 provided under subdivision (a) with respect to any qualified  
26 property leased to another qualified taxpayer.

27 (2) For purposes of paragraphs (2) and (3) of subdivision (b),  
28 “binding contract” shall include any lease agreement with respect  
29 to the qualified property.

30 (3) (A) For purposes of determining the qualified cost paid or  
31 incurred by a lessee in any leasing transaction that is not treated as  
32 a sale under Part 1 (commencing with Section 6001), the following  
33 rules shall apply:

34 (i) Except as provided by subparagraph (C) of this paragraph,  
35 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)  
36 shall not apply.

37 (ii) Except as provided in subparagraph (B) and clause (iii), the  
38 “qualified cost” upon which the lessee shall compute the credit  
39 provided under this section shall be equal to the original cost to the

1 lessor (within the meaning of Section 24912) of the qualified  
2 property that is the subject of the lease.

3 (iii) Except as provided in clause (iv), the requirement of  
4 subparagraph (B) of paragraph (1) of subdivision (b) shall be  
5 treated as satisfied only if the lessor has made a timely election  
6 under either Section 6094.1 or subdivision (d) of Section 6244 and  
7 has paid sales tax reimbursement or use tax measured by the  
8 purchase price of the qualified property (within the meaning of  
9 paragraph (5) of subdivision (g) of Section 6006). For purposes of  
10 this subdivision and clause (iv), the amount of original cost to the  
11 lessor which may be taken into account under clause (ii) shall not  
12 exceed the purchase price upon which sales tax reimbursement or  
13 use tax has been paid under the preceding sentence or under clause  
14 (iv).

15 (iv) With respect to leases entered into between January 1,  
16 1994, and the effective date of this clause, the lessor may elect to  
17 pay use tax measured by the purchase price of the property by  
18 reporting and paying the tax with the return of the lessor for the  
19 fourth calendar quarter of 1994. In computing the use tax under the  
20 preceding sentence, a credit shall be allowed under Part 1  
21 (commencing with Section 6001) for all sales or use tax previously  
22 paid on the lease.

23 (B) For purposes of applying subparagraph (A) only, the  
24 following special rules shall apply:

25 (i) The original cost to the lessor of the qualified property shall  
26 be reduced by the amount of any original cost of that property that  
27 was taken into account by any predecessor lessee in computing the  
28 credit allowable under this section.

29 (ii) Clause (i) shall not apply in any case where the predecessor  
30 lessee was required to recapture the credit provided under this  
31 section pursuant to subdivision (g).

32 (iii) For purposes of this section only, in any case where a  
33 successor lessor has acquired qualified property from a  
34 predecessor lessor in a transaction not treated as a sale under Part  
35 1 (commencing with Section 6001), the original cost to the  
36 successor lessor of the qualified property shall be reduced by the  
37 amount of the original cost of the qualified property that was taken  
38 into account by any lessee of the predecessor lessor in computing  
39 the credit allowable under this section.



(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i), shall be taken into account. In the case of any qualified property constructed, reconstructed, or acquired by a lessor pursuant to a binding contract in existence on or prior to January 1, 1994, the allocation rule specified in subparagraph (A) of paragraph (1) of subdivision (b) shall apply in determining the original cost to the lessor of qualified property.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any party related to the lessee within the meaning of Section 267 or 318 of the Internal Revenue Code) acquires the qualified property from the lessor (or any successor lessor) within one year from the date the qualified property is first used by the lessee under the terms of the lease, the lessee's (or related party's) acquisition of the qualified property from the lessor (or successor lessor) shall be treated as a disposition by the lessee of the qualified property that was subject to the lease under subdivision (g).

(4) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(A) Subparagraph (A) of paragraph (1) of subdivision (b) shall be applied by substituting the term "purchase" for the term "construction, reconstruction, or acquisition."

(B) Subparagraph (C) of paragraph (1) of subdivision (b) shall apply.

(C) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied at the time that either the lessor or the qualified taxpayer pays sales or use tax under Part 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's taxable year in which the credit is allowable to the lessee under this section.

1 (B) The statement required under subparagraph (A) shall be  
2 made available to the Franchise Tax Board upon request.

3 (6) For purposes of this subdivision, in the case of any qualified  
4 taxpayer engaged in those lines of business described in Codes  
5 7371 to 7373, inclusive, of the Standard Industrial Classification  
6 (SIC) Manual published by the United States Office of  
7 Management and Budget, 1987 edition, “the first taxable year  
8 beginning on or after January 1, 1998,” shall be substituted for  
9 “January 1, 1994,” in each place in which it appears. In addition,  
10 “the effective date of this paragraph” shall be substituted for “the  
11 effective date of this clause” and “fourth calendar quarter of  
12 1998” shall be substituted for “fourth calendar quarter of 1994.”

13 (g) No credit shall be allowed if the qualified property is  
14 removed from the state, is disposed of to an unrelated party, or is  
15 used for any purpose not qualifying for the credit provided in this  
16 section in the same taxable year in which the qualified property is  
17 first placed in service in this state. If any qualified property for  
18 which a credit is allowed pursuant to this section is thereafter  
19 removed from this state, disposed of to an unrelated party, or used  
20 for any purpose not qualifying for the credit provided in this  
21 section within one year from the date the qualified property is first  
22 placed in service in this state, the amount of the credit allowed by  
23 this section for that qualified property shall be recaptured by  
24 adding that credit amount to the net tax of the qualified taxpayer  
25 for the taxable year in which the qualified property is disposed of,  
26 removed, or put to an ineligible use. The sale of stock for which  
27 an election was made or deemed to have been made pursuant to  
28 Section 338(g) or 338(h)(10) of the Internal Revenue Code may  
29 not be treated as a disposition of qualified property to an unrelated  
30 party for purposes of this subdivision.

31 (h) In the case where the credit allowed by this section exceeds  
32 the “tax,” the excess may be carried over to reduce the “tax” in  
33 the following year, and succeeding years as follows:

34 (1) Except as provided in paragraph (2), for the seven  
35 succeeding years if necessary, until the credit is exhausted.

36 (2) In the case of a small business, for the nine succeeding  
37 years, if necessary, until the credit is exhausted.

38 (i) (1) This section shall remain in effect until the date  
39 specified in paragraph (2) on which date this section shall cease to  
40 be operative, and as of that date is repealed.



(2) This section shall cease to be operative on January 1, 2011.

(j) The amendments made by Chapter 954 of the Statutes of 1996 shall be operative for taxable years beginning on or after January 1, 1997, except as provided in paragraph (3) of subdivision (d).

(k) The amendments made by Chapter 323 of the Statutes of 1998 shall be operative for taxable years beginning on or after January 1, 1998.

SEC. 8. Section 23651 is added to the Revenue and Taxation Code, to read:

23651. (a) A qualified taxpayer shall be allowed a credit against the "tax," as defined in Section 23036, in an amount equal to 6 percent of the qualified cost of qualified property that is placed in service in this state. For purposes of this subdivision, the applicable percentage is:

(1) Two percent for property placed in service on or after January 1, 2005, and before January 1, 2006.

(2) Three percent for property placed in service on or after January 1, 2006, and before January 1, 2007.

(3) Four percent for property placed in service on or after January 1, 2007, and before January 1, 2008.

(4) Five percent for property placed in service on or after January 1, 2008, and before January 1, 2009.

(5) Six percent for property placed in service on or after January 1, 2009, and before January 1, 2010.

(6) Seven percent for property placed in service on or after January 1, 2010.

(b) (1) For purposes of this section, "qualified cost" means any cost that satisfies each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2005, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i). In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or prior to January 1, 2005, costs paid pursuant to that contract shall be subject to allocation as follows: contract costs shall be allocated to

1 qualified property based on a ratio of costs actually paid prior to  
2 January 1, 2005, and total contract costs actually paid. “Cost paid”  
3 shall include, without limitation, contractual deposits and option  
4 payments. To the extent of cost allocated, whether or not currently  
5 deductible or depreciable for tax purposes, to a period prior to  
6 January 1, 2005, the cost shall be deemed allocated to property  
7 acquired before January 1, 2005, and is thus not a “qualified cost.”

8 (B) Except as provided in paragraph (3) of subdivision (d) and  
9 subparagraph (B) of paragraph (4) of subdivision (d), is an amount  
10 upon which the qualified taxpayer has paid, directly or indirectly,  
11 as a separately stated contract amount or as determined from the  
12 records of the qualified taxpayer, sales or use tax under Part 1  
13 (commencing with Section 6001).

14 (C) Is an amount properly chargeable to the capital account of  
15 the qualified taxpayer.

16 (2) (A) For purposes of this subdivision, any contract entered  
17 into on or after January 1, 2005, that is a successor or replacement  
18 contract to a contract that was binding prior to January 1, 2005,  
19 shall be treated as a binding contract in existence prior to January  
20 1, 2005.

21 (B) If a successor or replacement contract is entered into on or  
22 after January 1, 2005, and the subject of the successor or  
23 replacement contract relates both to amounts for the construction,  
24 reconstruction, or acquisition of qualified property described in  
25 the original binding contract and to costs for the construction,  
26 reconstruction, or acquisition of qualified property not described  
27 in the original binding contract, then the portion of those amounts  
28 described in the successor or replacement contract that were not  
29 described in the original binding contract shall not be treated as  
30 costs paid or incurred pursuant to a binding contract in existence  
31 on or prior to January 1, 2005, under subparagraph (A) of  
32 paragraph (1).

33 (3) (A) For purposes of this section, an option contract in  
34 existence prior to January 1, 2005, under which a qualified  
35 taxpayer (or any other person related to the qualified taxpayer  
36 within the meaning of Section 267 or 707 of the Internal Revenue  
37 Code) had an option to acquire qualified property, shall be treated  
38 as a binding contract under the rules in paragraph (2). For purposes  
39 of this subparagraph, an option contract shall not include an option  
40 under which the optionholder will forfeit an amount less than 10

1 percent of the fixed option price in the event the option is not  
2 exercised.

3 (B) For purposes of this section, a contract shall be treated as  
4 binding even if the contract is subject to a condition.

5 (c) (1) For purposes of this section, “qualified taxpayer”  
6 means any taxpayer that is both of the following:

7 (A) Engaged in those lines of business described in Codes 2011  
8 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the  
9 Standard Industrial Classification (SIC) Manual published by the  
10 United States Office of Management and Budget, 1987 edition.

11 (B) Certified, in the form and manner prescribed by the State  
12 Department of Education, as a qualified participant in the Career  
13 Technical Education Campaign pursuant to Section 52337 of the  
14 Education Code for the taxable year for which a credit is claimed  
15 under this section.

16 (2) In the case of any passthrough entity, the determination of  
17 whether a taxpayer is a qualified taxpayer under this section or  
18 Section 17053.51 shall be allowed to the passthrough entity and  
19 passed through to the partners or shareholders in accordance with  
20 applicable provisions of Part 10 (commencing with Section  
21 17001) or this part. For purposes of this paragraph, the term  
22 “passthrough entity” means any partnership or S corporation.

23 (3) The Franchise Tax Board may prescribe regulations to carry  
24 out the purposes of this section, including any regulations  
25 necessary to prevent the avoidance of the effect of this section  
26 through splitups, shell corporations, partnerships, tiered  
27 ownership structures, sale-leaseback transactions, or otherwise.

28 (d) For purposes of this section, “qualified property” means  
29 property that is described as any of the following:

30 (1) Tangible personal property that is defined in Section  
31 1245(a) of the Internal Revenue Code for use by a qualified  
32 taxpayer in those lines of business described in Codes 2011 to  
33 3999, inclusive, of the SIC Manual published by the United States  
34 Office of Management and Budget, 1987 edition, that is primarily  
35 used for any of the following:

36 (A) For the manufacturing, processing, refining, fabricating, or  
37 recycling of property, beginning at the point at which any raw  
38 materials are received by the qualified taxpayer and introduced  
39 into the process and ending at the point at which the  
40 manufacturing, processing, refining, fabricating, or recycling has

1 altered tangible personal property to its completed form, including  
2 packaging, if required.

3 (B) In research and development.

4 (C) To maintain, repair, measure, or test any property described  
5 in this paragraph.

6 (D) For pollution control that meets or exceeds standards  
7 established by the state or by any local or regional governmental  
8 agency within the state.

9 (E) For recycling.

10 (2) Computers and computer peripheral equipment, as defined  
11 in Section 168(i)(2)(B) of the Internal Revenue Code, that is  
12 tangible personal property as defined in Section 1245(a) of the  
13 Internal Revenue Code for use by a qualified taxpayer in those  
14 lines of business described in SIC Codes 7371 to 7373, inclusive,  
15 of the SIC Manual, 1987 edition, that is primarily used to develop  
16 or manufacture prepackaged software or custom software  
17 prepared to the special order of the purchaser who uses the  
18 program to produce and sell or license copies of the program as  
19 prepackaged software.

20 (3) The value of any capitalized labor costs that are directly  
21 allocable to the construction or modification of property described  
22 in paragraph (1) or (2).

23 (4) In the case of any qualified taxpayer engaged in  
24 manufacturing activities described in SIC Code 357 or 367, those  
25 activities related to biotechnology described in SIC Code 8731,  
26 those activities related to biopharmaceutical establishments only  
27 that are described in SIC Codes 2833 to 2836, inclusive, those  
28 activities related to space vehicles and parts described in SIC  
29 Codes 3761 to 3769, inclusive, those activities related to space  
30 satellites and communications satellites and equipment described  
31 in SIC Codes 3663 and 3812, or those activities related to  
32 semiconductor equipment manufacturing described in SIC Code  
33 3559, “qualified property” also includes the following:

34 (A) Special purpose buildings and foundations that are  
35 constructed or modified for use by the qualified taxpayer primarily  
36 in a manufacturing, processing, refining, or fabricating process, or  
37 as a research or storage facility primarily used in connection with  
38 a manufacturing process.

39 (B) The value of any capitalized labor costs that are directly  
40 allocable to the construction or modification of special purpose

buildings and foundations that are used primarily in the manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(C) (i) For purposes of this paragraph, “special purpose building and foundation” means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subparagraph (A).

(ii) A building is specifically designed and constructed or modified for a qualified purpose if it is not economical to design and construct the building for the intended purpose and then use the structure for a different purpose.

(iii) For purposes of clause (i) and clause (vi), a building is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building for nonqualified purposes does not preclude the building from being a special purpose building. “Incidental use” means a use which is both related and subordinate to the qualified purpose. It will be conclusively presumed that a use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualified purpose.

(iv) In the event an entire building does not qualify as a special purpose building, a taxpayer may establish that a portion of a building, and the foundation immediately underlying the portion, qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subparagraph.

(v) To the extent that a building is not a special purpose building as defined above, but a portion of the building qualifies for treatment as a special purpose building, then all equipment which exclusively supports the qualified purpose occurring within that portion and which would qualify as Internal Revenue Code Section 1245 property if it were not a fixture or affixed to the

1 building shall be treated as a cost of the portion of the building  
2 which qualifies for treatment as a special purpose building.

3 (vi) Buildings and foundations which do not meet the  
4 definition of a special purpose building and foundation set forth  
5 above include, but are not limited to: buildings designed and  
6 constructed or reconstructed principally to function as a general  
7 purpose manufacturing, industrial, or commercial building;  
8 research facilities that are used primarily prior to or after, or prior  
9 to and after, the manufacturing process; or storage facilities that  
10 are used primarily prior to or after, or prior to and after, completion  
11 of the manufacturing process. A research facility shall not be  
12 considered to be used primarily prior to or after, or prior to and  
13 after, the manufacturing process if its purpose and use relate  
14 exclusively to the development and regulatory approval of the  
15 manufacturing process for specific biopharmaceutical products. A  
16 research facility which is used primarily in connection with the  
17 discovery of an organism from which a biopharmaceutical product  
18 or process is developed does not meet the requirements of the  
19 preceding sentence.

20 (5) Subject to the provisions in subparagraph (B) of paragraph  
21 (1) of subdivision (b), qualified property also includes computer  
22 software that is primarily used for those purposes set forth in  
23 paragraph (1) or (2) of this subdivision.

24 (6) Qualified property does not include any of the following:

25 (A) Furniture.

26 (B) Facilities used for warehousing purposes after completion  
27 of the manufacturing process.

28 (C) Inventory.

29 (D) Equipment used in the extraction process.

30 (E) Equipment used to store finished products that have  
31 completed the manufacturing process.

32 (F) Any tangible personal property that is used in  
33 administration, general management, or marketing.

34 (e) For purposes of this section:

35 (1) "Biopharmaceutical activities" means those activities that  
36 use organisms or materials derived from organisms, and their  
37 cellular, subcellular, or molecular components, in order to provide  
38 pharmaceutical products for human or animal therapeutics and  
39 diagnostics. Biopharmaceutical activities make use of living  
40 organisms to make commercial products, as opposed to



1 pharmaceutical activities which make use of chemical compounds  
2 to produce commercial products.

3 (2) “Fabricating” means to make, build, create, produce, or  
4 assemble components or property to work in a new or different  
5 manner.

6 (3) “Manufacturing” means the activity of converting or  
7 conditioning property by changing the form, composition, quality,  
8 or character of the property for ultimate sale at retail or use in the  
9 manufacturing of a product to be ultimately sold at retail.  
10 Manufacturing includes any improvements to tangible personal  
11 property that result in a greater service life or greater functionality  
12 than that of the original property.

13 (4) “Other biotechnology activities” means activities  
14 consisting of the application of recombinant DNA technology to  
15 produce commercial products, as well as activities regarding  
16 pharmaceutical delivery systems designed to provide a measure of  
17 control over the rate, duration, and site of pharmaceutical delivery.

18 (5) “Primarily” means tangible personal property used 50  
19 percent or more of the time in an activity described in subdivision  
20 (d).

21 (6) “Process” means the period beginning at the point at which  
22 any raw materials are received by the qualified taxpayer and  
23 introduced into the manufacturing, processing, refining,  
24 fabricating, or recycling activity of the qualified person and  
25 ending at the point at which the manufacturing, processing,  
26 refining, fabricating, or recycling activity of the qualified taxpayer  
27 has altered tangible personal property to its completed form,  
28 including packaging, if required. Raw materials shall be  
29 considered to have been introduced into the process when the raw  
30 materials are stored on the same premises where the qualified  
31 taxpayer’s manufacturing, processing, refining, fabricating, or  
32 recycling activity is conducted. Raw materials that are stored on  
33 premises other than where the qualified taxpayer’s manufacturing,  
34 processing, refining, fabricating, or recycling activity is  
35 conducted, shall not be considered to have been introduced into the  
36 manufacturing, processing, refining, fabricating, or recycling  
37 process.

38 (7) “Processing” means the physical application of the  
39 materials and labor necessary to modify or change the  
40 characteristics of property.



1 (8) “Refining” means the process of converting a natural  
2 resource to an intermediate or finished product.

3 (9) “Research and development” means those activities that  
4 are described in Section 174 of the Internal Revenue Code or in any  
5 regulations thereunder.

6 (10) “Small business” means a qualified taxpayer that meets  
7 any of the following requirements during the taxable year for  
8 which the credit is allowed:

9 (A) Has gross receipts of less than fifty million dollars  
10 (\$50,000,000).

11 (B) Has net assets of less than fifty million dollars  
12 (\$50,000,000).

13 (C) Has a total credit of less than one million dollars  
14 (\$1,000,000).

15 (D) Is engaged in biopharmaceutical activities or other  
16 biotechnology activities that are described in Codes 2833 to 2836,  
17 inclusive, of the Standard Industrial Classification (SIC) Manual  
18 published by the United States Office of Management and Budget,  
19 1987 edition, and has not received regulatory approval for any  
20 product from the United States Food and Drug Administration.

21 (f) The credit allowed under subdivision (a) shall apply to  
22 qualified property that is acquired by or subject to lease by a  
23 qualified taxpayer, subject to the following special rules:

24 (1) A lessor of qualified property, irrespective of whether the  
25 lessor is a qualified taxpayer, shall not be allowed the credit  
26 provided under subdivision (a) with respect to any qualified  
27 property leased to another qualified taxpayer.

28 (2) For purposes of paragraphs (2) and (3) of subdivision (b),  
29 “binding contract” shall include any lease agreement with respect  
30 to the qualified property.

31 (3) (A) For purposes of determining the qualified cost paid or  
32 incurred by a lessee in any leasing transaction that is not treated as  
33 a sale under Part 1 (commencing with Section 6001), the following  
34 rules shall apply:

35 (i) Except as provided by subparagraph (C) of this paragraph,  
36 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)  
37 shall not apply.

38 (ii) Except as provided in subparagraph (B) and clause (iii), the  
39 “qualified cost” upon which the lessee shall compute the credit  
40 provided under this section shall be equal to the original cost to the

1 lessor (within the meaning of Section 18031) of the qualified  
2 property that is the subject of the lease.

3 (iii) Except as provided in clause (iv), the requirement of  
4 subparagraph (B) of paragraph (1) of subdivision (b) shall be  
5 treated as satisfied only if the lessor has made a timely election  
6 under either Section 6094.1 or subdivision (d) of Section 6244 and  
7 has paid sales tax reimbursement or use tax measured by the  
8 purchase price of the qualified property (within the meaning of  
9 paragraph (5) of subdivision (g) of Section 6006). For purposes of  
10 this subdivision and clause (iv), the amount of original cost to the  
11 lessor which may be taken into account under clause (ii) shall not  
12 exceed the purchase price upon which sales tax reimbursement or  
13 use tax has been paid under the preceding sentence or under clause  
14 (iv).

15 (iv) With respect to leases entered into between January 1,  
16 2005, and the effective date of this clause, the lessor may elect to  
17 pay use tax measured by the purchase price of the property by  
18 reporting and paying the tax with the return of the lessor for the  
19 fourth calendar quarter of 2005. In computing the use tax under the  
20 preceding sentence, a credit shall be allowed under Part 1  
21 (commencing with Section 6001) for all sales or use tax previously  
22 paid on the lease.

23 (B) For purposes of applying subparagraph (A) only, the  
24 following special rules shall apply:

25 (i) The original cost to the lessor of the qualified property shall  
26 be reduced by the amount of any original cost of that property that  
27 was taken into account by any predecessor lessee in computing the  
28 credit allowable under this section.

29 (ii) Clause (i) shall not apply in any case where the predecessor  
30 lessee was required to recapture the credit provided under this  
31 section pursuant to subdivision (g).

32 (iii) For purposes of this section only, in any case where a  
33 successor lessor has acquired qualified property from a  
34 predecessor lessor in a transaction not treated as a sale under Part  
35 1 (commencing with Section 6001), the original cost to the  
36 successor lessor of the qualified property shall be reduced by the  
37 amount of the original cost of the qualified property that was taken  
38 into account by any lessee of the predecessor lessor in computing  
39 the credit allowable under this section.

(C) In determining the original cost of any qualified property under this paragraph, only amounts paid or incurred by the lessor on or after January 1, 2005, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i), shall be taken into account. In the case of any qualified property constructed, reconstructed, or acquired by a lessor pursuant to a binding contract in existence on or prior to January 1, 2005, the allocation rule specified in subparagraph (A) of paragraph (1) of subdivision (b) shall apply in determining the original cost to the lessor of qualified property.

(D) Notwithstanding subparagraph (A), in the case of any leasing transaction for which the lessee is allowed the credit under this section and thereafter the lessee (or any party related to the lessee within the meaning of Section 267 or 318 of the Internal Revenue Code) acquires the qualified property from the lessor (or any successor lessor) within one year from the date the qualified property is first used by the lessee under the terms of the lease, the lessee's (or related party's) acquisition of the qualified property from the lessor (or successor lessor) shall be treated as a disposition by the lessee of the qualified property that was subject to the lease under subdivision (g).

(4) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(A) Subparagraph (A) of paragraph (1) of subdivision (b) shall be applied by substituting the term "purchase" for the term "construction, reconstruction, or acquisition."

(B) Subparagraph (C) of paragraph (1) of subdivision (b) shall apply.

(C) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied at the time that either the lessor or the qualified taxpayer pays sales or use tax under Part 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's taxable year in which the credit is allowable to the lessee under this section.

(B) The statement required under subparagraph (A) shall be made available to the Franchise Tax Board upon request.

(g) No credit shall be allowed if the qualified property is removed from the state, is disposed of to an unrelated party, or is used for any purpose not qualifying for the credit provided in this section in the same taxable year in which the qualified property is first placed in service in this state. If any qualified property for which a credit is allowed pursuant to this section is thereafter removed from this state, disposed of to an unrelated party, or used for any purpose not qualifying for the credit provided in this section within one year from the date the qualified property is first placed in service in this state, the amount of the credit allowed by this section for that qualified property shall be recaptured by adding that credit amount to the net tax of the qualified taxpayer for the taxable year in which the qualified property is disposed of, removed, or put to an ineligible use.

(h) In the case where the credit allowed by this section exceeds the “tax,” the excess may be carried over to reduce the “tax” in the following year, and succeeding years as follows:

(1) Except as provided in paragraph (2), for the seven succeeding years if necessary, until the credit is exhausted.

(2) In the case of a small business, for the nine succeeding years, if necessary, until the credit is exhausted.

(i) *The credit under this section shall be known as the “Career Technical Education Campaign” credit or as the “CTEC” credit.*

(j) This section shall become operative on January 1, 2005, and remain in effect only until January 1, 2012, and as of that date is repealed.

SEC. 9. There is hereby appropriated from the General Fund for expenditure in the 2003-04 fiscal year the sum of \_\_\_\_ dollars (\$\_\_\_\_) for allocation to the Franchise Tax Board in augmentation of Item 1730-001-0001 of the Budget Act of 2003.

~~SEC. 10. There is hereby appropriated from the General Fund for expenditure in the 2003-04 fiscal year the sum of \_\_\_\_ dollars (\$\_\_\_\_) for allocation to the State Department of Education in augmentation of Item \_\_\_\_ of the Budget Act of 2003. for its cost to administer this act.~~

1     *SEC. 10. This act provides for a tax levy within the meaning*  
2     *of Article IV of the Constitution and shall go into immediate effect.*

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